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No. 22092

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD R. CLEMENTS, Trustee in Bankruptcy of the Bankrupt Estates of STONE MOUNTAIN SNIDER, dba SNIDER FAMILY MARKETS, and RUBY E. SNIDER,

Plaintiff,

vs.

AUSTIN T. SNIDER and ANGELINE M. SNIDER, dba SNIDER FAMILY MARKETS,

Defendants.

APPELLANT'S OPENING BRIEF.

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AUSTIN T. SNIDER and ANGELINE M. SNIDER, dba SNIDER FAMILY MARKETS,

Defendants.

APPELLANT'S OPENING BRIEF.

Jurisdictional Basis.

This is an appeal from a final judgment made and entered in the U. S. District Court for the Southern District of California, Central Division (now Central District of California), and this appeal is prosecuted in accordance with the provisions of Rule 72 *et seq.* of the Federal Rules of Civil Procedure in the United States District Court.

On January 28, 1966, Stone Mountain Snider and Ruby E. Snider doing business as Snider Family Markets filed a voluntary petition in bankruptcy.

On June 22, 1966, the Trustee in Bankruptcy, Appellant herein, filed a complaint for the Recovery of a Preferential Transfer [Clk. Tr. p. 2].

On August 3, 1966, Austin T. Snider and Angeline M. Snider filed an Answer to the Complaint [Clk. Tr. p. 8].

On May 5, 1967, Austin T. Snider and Angeline M. Snider filed a Notice of Motion for Summary Judgment by Defendants, Memorandum of Points and Authorities and Affidavits of Austin T. Snider, Stone Mountain Snider and Harvey S. Krieger in Support Thereof, and Proposed Findings of Fact and Conclusions of Law and Proposed Summary Judgment [Clk. Tr. p. 11].

On May 17, 1967, the Appellant filed his Statement of Genuine Issue of Fact and Law [Clk. Tr. p. 58].

On May 18, 1967, the Motion for Summary Judgment was heard before the Honorable A. Andrew Hauk, Presiding Judge of the United States District Court. Judge Hauk ruled from the bench in favor of Appellees.

On May 23, 1967, Findings of Fact, Conclusions of Law and Summary Judgment was entered [Clk. Tr. p. 70].

On May 23, 1967, Notice of Signing and Filing of Judgment was filed.

On May 25, 1967, Notice of Appeal was filed by Appellant, together with Statement of Points on Appeal [Clk. Tr. pp. 72-76].

Statement of Case.

On August 15, 1964, the bankrupts purchased a business known as the Snider Family Markets from Austin T. Snider and Angeline M. Snider. Stone Mountain is the brother of Austin. On that date the bankrupts and the defendants executed certain documents in the office of Harvey S. Krieger, attorney for the defendants. The documents included a promissory note in the sum of $42,000.00, secured by a chattel mortgage encumbering all of the fixtures, inventory, equipment and other assets.

The chattel mortgage was acknowledged before Harvey S. Krieger, as notary public. The date set forth in the certificate of acknowledgment and the chattel mortgage is August 10, 1964. The defendants, Austin T. Snider and Angeline M. Snider, filed, recorded and published a notice of Intended Sale and Intended Mortgage, stating that the documents would be executed and the consideration paid on August 10, 1964.

It is admitted the execution and acknowledgment of the instruments occurred five days later, on August 15, 1964.

On December 24, 1965, after the bankrupts encountered financial difficulties, and became insolvent, the defendants, Austin T. Snider and Angeline M. Snider repossessed all of the fixtures, equipment and other assets of the business, and cancelled the promissory note.

On January 28, 1966, Stone Mountain and Ruby E. Snider filed voluntary petitions in bankruptcy. The Trustee in bankruptcy sued Austin T. Snider and his wife upon the theory that their chattel mortgage was invalid as to creditors because not properly acknowledged, and thus defective under Section 2957 of the Civil Code of California; and thus their security was not perfected until they repossessed it within four months of bankruptcy; and that the repossession by them within four months of bankruptcy was a preferential transfer voidable pursuant to Section 60 of the Bankruptcy Act (11 U.S.C. 96).

Appellant concedes that if the mortgage was properly acknowledged so as to comply with the law of California, then summary judgment was proper.

ARGUMENT.

POINT I.

The Chattel Mortgage Was Improperly Acknowledged, and Thus Defective as to Creditors.

The certificate of acknowledgment of the chattel mortgage contained a false statement, which all parties knew was false at the time they executed the documents. This clearly renders the chattel mortgage defective.

The provisions of the Civil Code relating to chattel mortgages should be strictly construed, since they give a special right of lien independent of possession, a situation unknown to the commonlaw with relation to personal property.

> *Kahriman v. Jones,* 203 Cal. 254, 255, 263 Pac. 537 (1928).

Civil Code Section 2957 (now repealed by the Commercial Code of California) provides in part:

> A mortgage of personal property . . . is void as against creditors of the mortgagor, and subsequent purchasers and encumbrancers of the property in good faith and for value, unless:
>
> 1. It is acknowledged, or proved and certified, in like manner as grants of real property:

The requisites for the act of acknowledgment are set forth in Sections 1185, 1188, and 1189 of the Civil Code.

> *Martin v. Crocker-Citizens National Bank,* 349 F. 2d 580, 582 (9 CA 1965).

Section 1185 of the Civil Code defines the act of Acknowledgment and states:

> The acknowledgment of an instrument must not be taken, unless the officer taking it knows or has satisfactory evidence, on the oath or affirmation of a credible witness, that the person making such acknowledgment is the individual who is described in and who executed the instrument; or, if executed by a corporation, that the person making such acknowledgment is the president or secretary of such corporation, or other person who executed it on its behalf.

However, the section which sets forth the requirements of the Acknowledgment is Section 1189, which defines the form of the certificates. It states in part:

> The certificate of acknowledgment, unless it is otherwise in this article provided, must be substantially in the following form:
>
> State of .....,)
>) ss
> County of .....,)
>
> "On this .... day of ....., in the year ....., before me (here insert name and quality of the officer), personally appeared ...., known to me (or proved to me on the oath of .....) to be/the person whose name is subscribed to the within instrument, and acknowledged that he (she or they) executed the same."

This case falls squarely within the ruling of *Martin v. Crocker-Citizens National Bank,* 349 F. 2d 580 (9 CA 1965). In that case, as here, the controversy

was between the trustee in bankruptcy and the chattel mortgagees, who had made the false statements. There, as here, the certificate contained knowingly false statements. The only distinction, is that in the *Martin* case, the certificate of the notary was false because it stated the signators had personally appeared before the notary, when they had not. In this case the certificate of the notary falsely stated the signators appeared before him on August 10, 1964, the date published and recorded in the Notices, when in fact they did not appear until August 15, 1964.

Judge Hauk at the hearing on the motion for summary judgment indicated that without a claim of prejudice or injury by creditors by reason of the false date, the trustee in bankruptcy could not complain. This ignores the clear language of this court in the *Martin* case;

> We think then, that at least as to existing creditors, the requirement of Civil Code Section 2957 that chattel mortgages be acknowledged in order to be valid prescribes a necessary step in the creation of the lien of the chattel mortgage itself, and not a method of giving constructive notice of an otherwise valid lien (p. 582).

In *Emeric v. Alvarado,* 90 Cal. 444, 478, 27 Pac. 356 (1891) an acknowledgment was ruled defective and void where the certificate incorrectly described the City and County of the Notary. The court held the acknowledgment defective because "material statements" were untrue.

The only excuse or reason given for swearing to this false statement is found on page 3 of the Affidavit of the Notary Public, Harvey Krieger [Transcript of Record, p. 51, lines 24-31]. He states:

> That it was not convenient for all parties to be present at the same time for execution of these documents on Monday, August 10, 1964, as originally contemplated, and it was necessary to then re-schedule an appointment for such purpose. An appointment was scheduled for Saturday morning, August 15, 1964, at 8:00 A.M., for all of said parties to be present in affiant's office for the purpose of executing said documents, which said date and times was ultimately the first convenient date and time on and after August 10, 1964, during which all parties could be present.

By this affidavit the Notary Public admits to the commission of a misdemeanor under Government Code Section 6203. It provides:

> Every officer authorized by law to make or give any certificate or other writing is guilty of a misdemeanor if he makes and delivers as true any certificate or writing containing statements which he knows to be false.

This proscription in the Government Code is not restricted only to false statement concerning the personal appearance of a signator before the notary but to "statements" in general.

POINT II.

Decisions in Other Jurisdictions Are Not Applicable Upon the Issue of the False Certificate of Acknowledgment.

While there are no California decisions dealing precisely with the issue of a knowingly false date in the certificate, there has been a decision on related facts in another state. However, *Martin v. Crocker-Citizens National Bank (supra)* points out why non-California decisions are not persuasive authority on this issue.

> In the instant case the defect was caused by the chattel mortgagee itself, the bank. On its premises, and under the supervision of its agents, the officers of the mortgagor were allowed to depart without having acknowledged their signatures. Under supervision of the bank's agents, a notary later made a false certificate that the mortgagor's officers had acknowledged their execution of the instrument. If such a complete disregard of the California statutes is to be treated as irrelevant, not for the protection of an innocent third person, but for the benefit of the party who so disregarded the statutes, it should be the California courts, and not the courts of another sovereign, which should announce that doctrine (p. 583).

The case dealing with the issue of a false date is *Tenney Co. v. Thomas,* 237 N.W. 710, 61 N.D. 202 (1931). There the Supreme Court of North Dakota held an acknowledgment valid even though the certificate's date was intentionally false. The court reasoned:

> We think, however, that the date is not an essential matter. The identity of the mortgagor, and the fact of acknowledgment are the material facts.

But a careful reading of the case demonstrates that it was not the chattel mortgagee who caused the false certificate to be made, but his brother; the chattel mortgagor. The mortgagor antedated the instrument in an attempt to prefer his brother and mortgagee as a creditor, without the chattel mortgagee's knowledge. This distinguishes that case on the facts from both the case at hand and the *Martin* case.

Furthermore, the case is clearly contrary to the decisions of California, such as *Kelsey v. Dunlap,* 7 Cal. 160 (1856), *Bryan v. Ramirez,* 8 Cal. 461 (1858), *Emeric v. Alvarado (supra)* and *Rolando v. Everitt,* 72 Cal. App. 2d 629, 165 P. 2d 33 (1946), all of which stress compliance with the form of the certificate set forth in Civil Code Sections 1188 and 1189.

It is clear from the facts of this case that after defendants had recorded and published their notice of sale, they wished to create the impression the instruments were actually executed and the consideration paid on August 10, 1964. They deliberately participated with their agent, the notary, in executing a false certificate of acknowledgment. Thus the entire act was tainted and the mortgage was void.

Dated: This 27th day of November, 1967.

Respectfully submitted,

RICHARD M. MONEYMAKER,
Attorney for Appellants.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD M. MONEYMAKER

No. 22092

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Appellant,

vs.

AUSTIN T. SNIDER and ANGELINE M. SNIDER, dba SNIDER FAMILY MARKETS,

Appellees.

On Appeal From the United States District Court for the Central District of California.

BRIEF FOR THE APPELLEES.

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Appellees.

On Appeal From the United States District Court for the Central District of California.

BRIEF FOR THE APPELLEES.

Jurisdictional Statement.

The Appellant Trustee in Bankruptcy filed a Complaint in the United States District Court for the recovery of an alleged preferential transfer under the provisions of the Federal Bankruptcy Act [Clk. Tr. pp. 2-7].

This is an appeal from a summary judgment in favor of the defendants in that action made and entered on May 22, 1967, by the Honorable A. Andrew Hauk, United States District Judge [Clk. Tr. pp. 70-71].

The appeal is prosecuted in accordance with the provisions of Rule 73 of the Federal Rules of Civil Procedure.

The courts of appeal have jurisdiction of appeals from all final decisions of the district courts of the United States, except where a direct review may be had in the Supreme Court. United States Code, Title 28, Sec. 1291.

The judgment entered on the granting of defendants' motion for summary judgment is a "final judgment".

Poss v. Lieberman, 299 F. 2d 358 (2 CA 1962).

Statement of the Case.

The appellant does not contravert the findings of fact made by the trial court in determining the appellees' motion for summary judgment, but in his statement of the case and argument he fails to set forth certain of these facts accurately. To the extent that it may bear upon the legal conclusion to be drawn from these facts, appellees submit their own statement of the case.

On August 15, 1964, the appellees, Austin T. Snider and Angeline M. Snider, sold a meat market and retail grocery business, commonly known as the "Snider Family Market", to Stone M. Snider, brother of Austin, and to his wife, Ruby Snider [Clk. Tr. pp. 19, 20, 45, 46]. All of the documents evidencing this transaction were prepared by Harvey S. Krieger, attorney for Austin T. Snider [Clk. Tr. pp. 21, 46, 50]. These documents included a Notice of Intended Sale, a Notice of Intended Mortgage, an Agreement of Sale, an Installment Note, and a Mortgage of Chattels [Clk. Tr. pp. 23, 29, 31, 54, 55].

The total purchase price of the business was $41,-600.00, all of which was evidenced by the Installment Note secured by the Mortgage of Chattels on all of the fixtures, shelving, display cases, machinery and equipment of the business [Clk. Tr. pp. 24, 29, 31, 67].

The Notice of Intended Sale and the Notice of Intended Mortgage were, each and both, dated July 24, 1964, recorded on July 27, 1964, and published on July 29, 1964, stating that the sale would be made and the mortgage delivered on or after August 10, 1964 [Clk. Tr. pp. 54, 55, 56, 57, 67].

The Agreement of Sale, the Installment Note, and the Mortgage of Chattels were, each and all, dated and prepared for execution and acknowledgement on August 10, 1964, but not executed and acknowledged until five days later, August 15, 1964, when all of the parties were first able to be personally present at the same time [Clk. Tr. pp. 21, 23, 29, 31, 45, 46, 51, 52, 67].

On August 15, 1964, at 8:00 A.M. all of the parties were present in Mr. Krieger's office, and in his presence and capacity as a notary public, and in the presence of each other, without changing the date in any of the documents, the sellers and purchasers executed the agreement, and the purchasers executed the note and mortgage and acknowledged their execution of the mortgage. Mr. Krieger, acting as a notary public, then executed the certificate of acknowledgment endorsed on the mortgage by affixing his signature and seal thereto [Clk. Tr. pp. 21, 46, 51, 52, 67].

Thus the sale was in fact made and the mortgage delivered on Saturday, August 15, 1964 Clk. Tr. pp.

19, 20, 21, 46, 51]. The Mortgage of Chattels was recorded on the following Monday afternoon, August 17, 1964, at 3:20 P.M. [Clk. Tr. pp. 31, 67].

The purchasers, Stone M. Snider and Ruby Snider, first took possession of the meat market and grocery business, and the fixtures, shelving, display cases, machinery and equipment of said business after the execution of the agreement, note and mortgage on August 15, 1964, and solely and exclusively operated said business until December 25, 1965 [Clk. Tr. pp. 20, 21, 46, 47, 67].

That as of December 16, 1965, the purchasers were delinquent in principal payments due on the note in the approximate amount of $4,900.00 [Clk. Tr. pp. 21, 47]. At the request of the parties, Mr. Krieger then prepared an Agreement of Renunciation and Surrender which was dated, signed and acknowledged on December 23, 1965, and recorded on December 28, 1965 [Clk. Tr. pp. 21, 22, 39, 47, 52, 53, 67, 68]. This agreement provided for the renunciation and surrender of all of the right, title and interest of the mortgagors in and to the fixtures, shelving, display cases, machinery and equipment of said business, as described in the Mortgage of Chattels, with the exception of certain shelving, grocery gondola and adding machine which the mortgagors had disposed of, in consideration for the mortgagees fully and finally discharging, acquitting and releasing the mortgagors from any and all further liability under the note secured by the mortgage [Clk. Tr. pp. 39, 67].

On January 28, 1966, Stone Mountain Snider, doing business as Snider Family Markets, and Ruby E. Snider filed voluntary petitions in bankruptcy. The appellant

sued appellees for the recovery of an alleged preferential transfer in two causes of action. The first alleged that the mortgage was not timely recorded and thus invalid as to creditors, and the second that the mortgage was not properly acknowledged and hence also invalid as to creditors. In either event, appellant asserted that appellees were nothing more than general unsecured creditors and that the transfer to them within four months preceding the filing of the bankruptcy constituted a voidable preference [Clk. Tr. p. 2].

In opposition to appellees' motion for summary judgment, and the affidavits in support thereof, appellant raised no genuine issue as to any material fact and apparently abandoned for the purpose of the motion, as well as this appeal, any contention that the mortgage was not timely recorded (Appellant's Br. p. 4).

In his statement of the case, moreover, appellant concedes that if the mortgage was properly acknowledged, summary judgment was proper (Appellant's Br. p. 4).

The Question Involved.

The sole question raised by this appeal is whether an erroneous date alone in the certificate of acknowledgment is sufficient to invalidate an otherwise properly acknowledged mortgage of chattels.

Summary of Argument.

The trial court properly determined that the mortgage of chattels was properly acknowledged and validly recorded, and there being no genuine issue of fact, that the appellees wee entitled to summary judgment as a matter of law.

ARGUMENT.

POINT I.

An Erroneous Date in a Certificate of Acknowledgment Does Not Itself Invalidate an Otherwise Properly Acknowledged Mortgage of Chattels.

The sole point that is in contention in this appeal was also presented and argued to the trial court in the motion for summary judgment. In fact, the very same authorities, without elaboration or deletion, were submitted by appellant below in support of the contention that the mortgage of chattels was not properly acknowledged.

The appellees are constrained to closely parrot their same argument in refutation.

As this appeal is made to turn on the significance of an erroneous date in the certificate of acknowledgment, so the appellant again argues that this case "falls squarely" ["on all fours"—Clk. Tr. p. 61, line 4] under *Martin v. Crocker-Citizens National Bank,* 349 F. 2d 580 (9 C.A. 1965). This contention remains the basic disagreement between respective counsel. Appellant's argument ignores the historic and legal distinction between the act of acknowledgment and the certificate of acknowledgment.

In the *Martin* case the act of acknowledgment was the very issue in dispute. The line of authorities are consistent in insisting upon compliance with the act or fact of acknowledgment. They are equally consistent in determining that the omission, mistake, error

or falsity of the date in the certificate of acknowledgment will not itself invalidate the certificate.

> "An acknowledgment is the declaration before a competent court or officer, by a person by whom an instrument has been executed, that such execution is his act and deed".
>
> 1 California Jurisprudence 2d, Sec. 2, p. 460;
>
> *De Wolfskill v. Smith,* 5 Cal. App. 175, 184, 89 Pac. 1001 (1907).

> "The certificate of acknowledgment is not a part of the contract or other instrument to which it is attached, but is merely a mode of proof, or prima facie evidence of a fact".
>
> 1 California Jurisprudence, 2d, Sec. 2, p. 460.

The requisites for the act of acknowledgment only are set forth in Section 1185 of the California Civil Code. This section provides that the acknowledgment of an instrument must not be taken unless the officer taking it knows, or is furnished evidence, that the person making the acknowledgment is the person described in the instrument.

In reversing the District Court (*In re Aerocolor,* 236 F. Supp. 84 (S. D. Cal. 1964)) the Court of Appeals in Martin determined that the chattel mortgage was not acknowledged where the officers of the mortgagor signed the mortgage and deposited it with the mortgagees without acknowledging their signatures in the presence of the notary public who attached his certificate to the document. The court concluded that the necessary step prescribed for the act of acknowledgment by California Civil Code Section 1185 had not been satisfied and hence no lien was created in that

the officer taking it did not know or have satisfactory evidence that the person making such acknowledgment was the individual who was described in and who executed the instrument. The critical question was the act of acknowledgment itself. In order to determine the manner in which the officer "knows or has satisfactory evidence" that the person making such acknowledgment is the individual who is described in and who executed the instrument, the Court necessarily looked to the form of the certificate of acknowledgment. This reference, however, was not intended to destroy the basic distinction between the act of acknowledgment and the certificate of acknowledgment, nor to impress upon the certificate strictures not otherwise intended.

In the acknowledgment is properly made, and the certificate only is defective, the instrument is valid.

1 California Jurisprudence 2d, Sec. 15, p. 483.

The four California cases cited by the appellant on page 10 of his opening brief, *Kelsey v. Dunlap,* 7 Cal. 160 (1856), *Bryan v. Ramirez,* 8 Cal. 461 (1858), *Emeric v. Alvarado,* 90 Cal. 444, 27 Pac. 356 (1891), and *Rolando v. Everitt,* 72 Cal. App. 2d 629, 165 P. 2d 33 (1946), are all cases turning on requisites for the act of acknowledgment.

Thus, in *Kelsey,* there was no statement that the person making the acknowledgment was either personally known, or proved to the officer to be the person who executed the instrument.

In *Bryan,* there was no statement of the fact of acknowledgment by the person who executed the instrument.

In *Emeric,* the officer taking the acknowledgment was not a notary in the County where the acknowledgment purportedly took place. The material element again concerned the act of acknowledgment and the authority of the officer to take an acknowledgment.

Finally, in *Rolando,* the act of acknowledgment was that by an individual rather than by a partnership.

The only other California case cited by appellant, *Kahriman v. Jones,* 203 Cal. 254, 263 Pac. 537 (1928), involved neither the act of acknowledgment nor the certificate of acknowledgment, but rather the fatal effect of the absence on the face of a chattel mortgage of the due date of the debt secured thereby.

On the other hand, there are a number of uniform decisions throughout the United States on the non-fatal effect of an ommission, mistake, error or falsity in the date of an otherwise properly acknowledged certificate of acknowledgment.

> "It is the general practice to specify in a certificate of acknowledgment the date upon which the acknowledgment is taken, but if a certificate is sufficient in other particulars, the mere omission of the date or some part thereof from a certificate is not necessarily fatal".
>
> 1 American Jurisprudence 2d, Sec. 47, p. 478.

Three cases to this effect are *Dahlem's Estate,* 175 Pa. 454, 35 Atl. 807 (1896) (an ommission of the date in the certificate of acknowledgment of a mortgage did not invalidate the line of the mortgage, if the date of the acknowledgment appears from an inspection of the whole instrument); *Hasley v. Bunte,* 176 Okla. 457, 56 P. 2d 119 (1936) (undated certifi-

cate of acknowledgment did not vitiate deed); and *Barouh v. Israel,* 46 Wash. 2d 37, 281 P. 2d 238 (1955) (blank date in certificate of acknowledgment in declaration of homestead not a material defect).

> "If the certificate of acknowledgment is dated earlier than the instrument, but it is clearly shown that the date is errneous, that fact alone does not invalidate the certificate. In fact, if no date appears in the certificate, or if the date is rendered by evidence within the instrument itself so doubtful as to destroy its force, the certificate is presumed to have been made at the date of the instrument".
>
> 1 California Jurisprudence 2d, Sec. 29, p. 503.

Two cases to this effect are *Fisher v. Butcher,* 19 Ohio 406 (1850) (where it was held not error to admit a deed in evidence even though the certificate of acknowledgment bore a date prior to the time of making the deed when from the instrument it appeared that it was actually made at the time of its acknowledgment, and that the contradiction in date arose from a mere clerical error); and *Brown v. Title Ins. & Trust Co.,* 51 Cal. App. 65, 196 Pac. 114 (1921) (rehearing denied by Supreme Court) (where the date stated in the certificate of acknowledgment for a deed was obviously wrong on its face, the certificate was treated as undated and was presumed to have been made on the date of the execution of the deed).

> "The date of the certificate is not an essential part thereof, and its omission, or a mistake therein, will not of itself invalidate the certificate".
>
> 1 Corpus Juris Secundum, Sec. 85, p. 843.

The mere omission from the certificate of the date or a mistake in the date of the certificate does not ordinarily invalidate it.

25 American Law Reports 2d, p. 1141.

> "The date as stated in the certificate of acknowledgment is not regarded as a material fact as to which accuracy is required. Consequently a certificate otherwise sufficient will not be rendered void by the entire absence of a date or by mistake in the date, or although the date is intentionally false. . . . The true date of the acknowledgment in these cases may ordinarily be shown by parol".

1 Corpus Juris Secundum, Sec. 85, p. 843.

In the context of intentional falsity is *Tenney Co. v. Thomas,* 61 N.D. 202, 237 N.W. 710 (1931) (where a mortgage was executed October 8th, dated back to June 24th, and delivered on October 9th, it was still held superior to a mortgage executed and delivered on December 14th). The Court in *Tenney* held that the date was not an essential matter, that the identity of the mortgagor and the fact of his acknowledgment are the material facts.

> "Before a certificate of acknowledgment will be held fatally defective there must be an absence of some essential fact of a substantial character. (citation). We therefore hold that though the date of the certificate of acknowledgment was intentionally false, the mortgage was, nevertheless, properly filed".

Tenney, supra, at p. 209.

Unlike the *Martin* case the mortgagors here personally acknowledged their execution in the presence of the notary, and in fact executed all of the documents in his presence. Unlike even the *Tenney* case there was no attempt by any of the parties to antedate any of the agreements in this contemporaneous, good faith transaction, for present consideration.

The appellant's charge that all parties, or any party other than the notary, knew that the date in the certificate of acknowledgment had not been changed from August 10, 1964, to August 15, 1964, is without factual support in the record or otherwise (Appellant's Br. p. 5).

The appellant's charge that the parties "deliberately participated with their (sic) agent, the notary, in executing a false certificate of acknowledgment" is incomprehensible and inexplicable.

There was no conspiracy, attempt, or intent, covert or overt, to antedate any of the documents, and no purpose to be served thereby even presuming such intent. Each and all of the documents were prepared for execution on August 10, 1964, and except for the simple but true fact that all of the parties were unable to meet together until five days later, they would have been signed and acknowledged on the earlier date. The published notices, moreover, specifically stated on or after August 10, 1964. And, finally, there was no delivery of title or possession of the mortgaged chattels until the date of actual execution.

Conclusion.

For the reasons herein stated, the summary judgment in favor of the appellees should be affirmed.

Dated: This 26th day of December, 1967.

Respectfully submitted,

HARVEY S. KRIEGER,
Attorney for Appellees.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HARVEY S. KRIEGER

No. 22092

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD R. CLEMENTS, Trustee in Bankruptcy of the Bankrupt Estates of STONE MOUNTAIN SNIDER, dba SNIDER FAMILY MARKETS, and RUBY E. SNIDER,

Appellant,

vs.

AUSTIN T. SNIDER and ANGELINE M. SNIDER, dba SNIDER FAMILY MARKETS,

Appellees.

APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

POINT I.
The Acknowledgment Is Invalid if the Certificate Is Incorrect.

Appellees major defense is to attempt to distinguish between the act of acknowledgment and the certificate of acknowledgment. No such distinction is made in the California authorities. For example, Section 1185 of the Civil Code of California purports to set forth the requisites of the act of acknowledgment.

> The acknowledgment of an instrument must not be taken, unless the officer taking it knows or has satisfactory evidence, on the oath or affirmation of a credible witness, that the person making such acknowledgment is the individual who is described in and who executed the instrument; or, if executed by a corporation, that the person making such

> acknowledgment is the president or secretary of such corporation, or other person who executed it on its behalf.

Note that this code section does not require the person making the acknowledgment to personally appear before the officer taking the acknowledgment. Yet the law is now clear that unless the persons do personally appear before the officer taking the acknowledgment, the acknowledgment and the instrument is defective.

> *Martin v. Crocker-Citizens National Bank,* 349 F. 2d 580 (1965).

Where then in the law is there such a requirement? It is only found in the *form of the certificate of acknowledgment,* set forth in Section 1189 of the Civil Code of California.

In the *Martin* case it was clear the proper parties actually did sign the chattel mortgage.

> On its premises, and under the supervision of its agents, the officers of the mortgagor signed the mortgage, and were allowed to depart without having acknowledged their signatures. (P. 583.)

There was no contention that the notary public, who was an employee of the Bank, had any reason to doubt the authenticity of the signatures, which in fact were authentic. Only the certificate was false, and knowingly false.

The rule of strict compliance with the form of the certificate as set forth in Civil Code Section 1189 was followed in *Emeric v. Alvarado,* 90 Cal. 444, 478, 27 Pac. 356 (1891). There a deed was held not properly acknowledged because of the untruth of material statements in the certificate.

The certificate of acknowledgment in a deed to one Patrick stated incorrectly that the certifier was a notary public in the city and county of San Francisco, while in fact, the notary public was only qualified in Contra Costa County, which his seal, affixed to the certificate, clearly showed. The deed had been acknowledged properly by the notary in Contra Costa County. Thus the only error was contained in the certificate of acknowledgment which read, in part:

> State of California, City and County of San Francisco s.s.
> On this eight day of December, A.D., 1879 before me, H. I. Tillofson, a notary public in and for said city and county. . . .

The court held material statements in the certificate were not true, and thus invalidated the acknowledgment. Are false statements concerning the capacity of the acknowledging office more material than a knowingly false date? Obviously not. Particularly when the error, in Emeric certificate, could be seen from the notary seal. It was not so apparent in the case at hand.

Appellees interpretation of the holding of this case, to the effect that "the officer taking the acknowledgment was not a notary in the County where the acknowledgment purportedly took place," (Appellees Br. p. 9, 1st par.) is not correct. The notary was such where the acknowledgment was made. Only the certificate was erroneous as to where it took place and as to the Notary's capacity in that county. Had the notary simply deleted the words "San Francisco," and inserted the words "Contra Costa" the certificate would have been true, and the acknowledgment valid.

Again, in *Kelsey v. Dunlap,* 7 Cal. 160 (1856), and *Bryan v. Ramirez,* 8 Cal. 461 (1858) there was no question but that the act of acknowledgment took place, and the signatures were authentic. The acknowledgments were held invalid, however, because the *certificates* were defective, and did not comply with Civil Code Section 1189.

Appellant cites *Brown v. Title Ins. Etc. Co.,* 51 Cal. App. 65, 196 Pac. 114 (1921) which held a certificate of acknowledgment valid even though the date was incorrect because of a clerical error. The case is distinguishable on two grounds.

1. No clerical error occurred in the case at hand. Appellant's notary knew the date was false when he signed the certificate and he did not change the date of the certificate to the correct date.

2. The correct date in the *Brown* case could be determined from the instrument itself. But in the case at hand the mortgage was also incorrectly dated, and thus the correct date could not be so determined.

Appellee cites authorities from many other jurisdictions, holding an error in the certificate, or an incorrect date, do not invalidate the instrument. But *Martin v. Crocker-Citizens National Bank (supra)* points out why only California authorities are applicable. And all California authorities hold the correctness of the certificate is essential, even when the act of acknowledgment is done properly.

Respectfully submitted,

RICHARD M. MONEYMAKER,
Attorney for Appellant.

Certificate.

I certify that, in the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

R. M. MONEYMAKER

No. 22093

United States
Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

LEE HOFFMAN and JUDY HOFFMAN,
husband and wife,

Appellees.

On Appeal from the Judgment of the United States District Court for the District of Oregon

BRIEF FOR THE APPELLANT

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No. 22093

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UNITED STATES OF AMERICA,

Appellant,

vs.

LEE HOFFMAN and JUDY HOFFMAN,
husband and wife,

Appellees.

On Appeal from the Judgment of the United States District Court for the District of Oregon

BRIEF FOR THE APPELLANT

OPINION BELOW

The opinion and order of the United States District Court for the District of Oregon (R. 78-83) are not officially reported.

JURISDICTION

This appeal involves federal income taxes for the years 1958 through 1961. The taxes in dispute were

paid as follows: $6,254.31 on or about October 15, 1959; $2,447.99 on or about April 15, 1960; $2,185.53 on or about April 15, 1961; and $2,056 on or about April 15, 1962. (R. 1-2.) Claims for refund were filed on or about March 29, 1965 (R. 2-3), and were rejected on or about June 29, 1965, except that the claim for refund for the year 1961 was allowed in the amount of $243.99 (R. 3). Within the time provided in Section 6532 of the Internal Revenue Code of 1954, on November 19, 1965, taxpayers brought an action in the District Court for the recovery of taxes paid. (R. 1-22, 94.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgment of the District Court was entered on March 21, 1967. (R. 84, 95.) Within sixty days thereafter, on May 17, 1967, the United States filed a notice of appeal. (R. 85, 95.) On July 10, 1967, the United States filed a motion with the District Court to amend the judgment previously entered. (R. 87-88, 95.) The motion to amend the judgment was denied on July 24, 1967. (R. 92, 95.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED

1. Whether the District Court erred in holding that the losses incurred by the taxpayers (sole stockholder of a corporation and his wife) as indemnitors of the corporation's surety-creditor were

ordinary losses incurred in a transaction entered into for profit though not connected with taxpayers' trade or business within the provisions of Section 165(c)(2) of the Internal Revenue Code of 1954, rather than nonbusiness bad debt losses within the provisions of Section 166(d) deductible only as capital losses.

2. Whether, assuming that there was no debt owing to taxpayers by the corporation by reason of their payments pursuant to the indemnity agreement, the payments represented contributions to the corporate capital deductible only as capital losses within the provisions of Section 165(f) and (g) of the Internal Revenue Code of 1954.

3. Whether, even assuming (as the District Court held) that the losses were incurred in a transaction entered into for profit though not connected with taxpayers' trade or business, within the meaning of Section 165(c)(2), the District Court erred in granting judgment to taxpayers in the amount of $9,345.61, and in failing to grant the motion of the Government to amend the amount of the judgment to $1,812.01 on the ground that such loss cannot be carried back to prior years under the provisions of Section 172 of the Internal Revenue Code of 1954.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations involved are set out in the Appendix, *infra*.

STATEMENT

The basic facts are undisputed[1] and, as found by the District Court, may be stated as follows:

Taxpayers, Lee and Judy Hoffman, brought this action to recover $9,345.61 in federal income taxes paid for the years 1958 through 1961. (R .78-79.)

Prior to 1958, Lee Hoffman operated a contracting business as sole proprietor. In 1958, he organized Lee Hoffman, Inc., (the "corporation") to operate the existing contracting business. He was the president, director and sole shareholder of the corporation and received a salary for his service as president. (R. 79.)

The General Insurance Company of America (hereinafter sometimes referred to as the Bonding Company), in 1958, agreed to furnish performance and payment bonds for the corporation's construction jobs and taxpayers individually agreed to indemnify the Bonding Company for any loss incurred from having executed the bond. (R. 79-80.)

Lee Hoffman, Inc., obtained construction contracts in 1959 and 1960 from Oak Lodge Sanitary

[1] Taxpayers and the United States both moved for summary judment, and the case was treated as submitted on stipulated facts. (R. 79.)

Districts No. 1 and No. 2, and delivered two payment and performance bonds to the sanitary districts. (R. 80.)

Subsequently, Lee Hoffman, Inc., suffered financial losses. On April 11, 1961, in order to obtain additional funds, the corporation contracted with taxpayers, with the Bonding Company and with the First National Bank of Oregon, whereby the bank agreed to lend money to the corporation if the Bonding Company would request the loan and if taxpayers individually indemnified the bank and the Bonding Company for all sums advanced. Ten days later, taxpayers sold real estate and turned over the entire proceeds, $20,400.83, to the Bonding Company on account of the funds advanced. (R. 80.)

On November 20, 1961, the Bonding Company paid the bank in full for the monies advanced and terminated its agreement with the bank. On the following day, the Bonding Company agreed to advance to the corporation the funds needed to complete its construction contracts and taxpayers individually agreed to indemnify the Bonding Company for any loss resulting from the advances. (R. 80.)

As of November 30, 1962, taxpayers had paid the Bonding Company $3,740. On November 30, 1962, taxpayers transferred $56,283.40 in cash, stocks and

realty to the Bonding Company for a release from all liability to the Bonding Company which, at that time was in excess of $900,000. (R. 80-81.)

Taxpayers filed timely refund claims with the Internal Revenue Service with respect to their taxable years 1958-1961, contending that the amounts paid to the Bonding Company in 1961 and 1962 were deductible as ordinary losses within the provisions of Section 165(c)(2) of the Internal Revenue Code of 1954. These claims were rejected by the Internal Revenue Service (R. 81), and this suit for refund followed.

In the District Court, taxpayers contended that the payments to the Bonding Company represented losses incurred in a transaction entered into for profit though not connected with their trade or business, deductible as ordinary losses within the provisions of Section 165(c)(2). The United States contended that the losses were deductible only as capital losses, either as nonbusiness bad debts within provisions of Section 166(d) of the Internal Revenue Code of 1954 or as worthless stock losses within the provisions of Sections 165(f) and (g) of the Internal Revenue Code of 1954. (R. 81.) The District Court sustained the taxpayers' contention that the losses were incurred in a transaction entered into for profit though not connected with

their trade or business. (R. 83.) Judgment in the amount of $9,345.61 was entered in favor of taxpayers, and this appeal followed. (R. 84-85.)

Subsequent to the filing of the notice of appeal, the United States moved that the judgment be amended so that taxpayers be awarded $1,812.01 rather than $9,345.61, on the ground that, under Section 172(c) and (d)(4) of the Internal Revenue Code of 1954, losses resulting from a transaction entered into for profit though not connected with a taxpayer's trade or business cannot be carried back and set off against the business income of prior years, as was done by the judgment of the District Court. (R. 87-88.) The Government's motion was denied. (R. 92.)

SPECIFICATION OF ERRORS RELIED UPON

1. The District Court erred in holding that indemnity payments by taxpayers to the corporation's surety-creditor were deductible within the provisions of Section 165(c)(2) of the Internal Revenue Code of 1954 as an ordinary losses incurred in the transaction entered into for profit though not connected with their trade or business, and in failing to hold that the payments resulted in a capital loss either as nonbusiness bad debts within the provisions of Section 166(d) of the Internal Reve-

nue Code of 1954 or as additional contributions to the corporate capital resulting in worthless stock investments within the provisions of Section 165(f) and (g) of the Internal Revenue Code of 1954.

2. In the alternative, and assuming that the losses were incurred in a transaction entered into for profit though not connected with taxpayers' trade or business, the District Court erred in granting judgment to taxpayers in the amount of $9,345.61, and in failing to grant the motion of the United States to amend the judgment to $1,812.01, since such nonbusiness losses cannot, under Section 172 of the Internal Revenue Code of 1954, be carried back to prior tax years.

SUMMARY OF ARGUMENT

The taxpayers, sole stockholder of a construction corporation and his wife, agreed to indemnify a bonding company for any losses resulting from that company's guaranty of performance of the corporation's construction contracts. The corporation suffered financial reverses, the bonding company paid construction creditors of the corporation, the taxpayers indemnified the bonding company pursuant to the indeminty agreement, and the corporation ws unable to reimburse the taxpayers. The Government contended that taxpayers' indemnity payments were deductible as capital losses—either as nonbusiness bad debts under 1954 Code Section 166(d), or as worthless stock losses under Section 165(f) and (g). The District Court, rejecting those contentions, held that the payments were deductible as ordinary losses under Section 165(c)(2). We submit that the District Court clearly erred as a matter of law.

1. Code Section 165(c)(2) authorizes the deduction in full of individual "losses incurred in any transaction entered into for profit, though not connected with a trade or business". However, Section 166(d) requires short-term capital loss treatment "where any nonbusiness debt becomes worthless within the taxable year". In *Putnam v. Commissioner*, 352 U.S. 82, the Supreme Court held (pp. 87-88) that

these sections are mutually exclusive, and that losses incurred by a stockholder as guarantor of loans to his corporation, if deductible at all, are deductible only under the "special limitation provisions" of Section 166(d) relating to nonbusiness bad debts, not under the "general loss provisions" of Section 165(c)(2). The Court pointed out that capital loss treatment of stockholder losses resulting from agreements guaranteeing repayment of third party loans to the corporation is in keeping with the Congressional intent to accord similar treatment to losses sustained by a stockholder who directly advances or contributes funds to an unsuccessful corporation. Under the *Putnam* rationale, the losses sustained by taxpayers by reason of the indemnity agreement here involved constitute nonbusiness bad debt losses within the purview of Section 166(d), and are no less subject to the capital loss limitations imposed by that section than losses resulting from the guaranty agreement there involved.

The District Court deemed *Putnam* inapplicable to a stockholder who enters into an "indemnity" rather than a "guaranty" agreement, apparently on the theory that, unlike a guarantor who is secondarily liable for the corporation, and is subrogated to the rights of the lender-creditor, an indemnitor is primarily liable (together with the borrower-corporation) to the lender-creditor and need not rely on the

doctrine of subrogation in seeking reimbursement from the debtor corporation. The theory is untenable for either of two separate reasons: (1) it is clear from decisions of this Court and the Supreme Court of Oregon that an indemnitor under the type of agreement here involved is entitled under Oregon law to be subrogated to the rights of the indemnified creditor; (2) in any event, whether a loss is deductible as an ordinary or capital loss for federal income tax purposes is not dependent on state law distinctions between a "guaranty" and an "indemnity" agreement, so that even in the absence of a right of subrogation a loss incurred by a stockholder-indemnitor is a nonbusiness bad debt loss falling within the purview of Section 166(d) as interpreted in *Putnam*. To permit the federal tax consequence to turn on whether the stockholder's agreement to hold the corporation's creditor harmless is labeled an "indemnity" or a "guaranty" agreement, or on whether under state law his right to reimbursement from the debtor corporation stems from subrogation rather than some other equitable principle, would exalt form over substance, disregard business realities, and violate the fundamental rule that the federal taxing statute is to be applied wherever possible with nationwide uniformity. Nothing in the relevant statutory provisions, their history, the Treasury Regulations, or the controlling decisions warrants the conclusion that Congress intended the na-

ture of the loss here in question—ordinary versus capital—to depend on any formalistic distinctions between a "guarantor" and "indemnitor". On the contrary, as the Supreme Court held in *Putnam*, Congress intended to treat all losses incurred by a stockholder who lends his credit to the corporation —whether in the form of a direct loan, or indirectly as guarantor or indemnitor of third party loans— in the same manner, i.e. as capital losses.

The Congressional intent to treat losses like those here involved as capital losses from nonbusiness bad debts is confirmed by 1954 Code Section 166(f). That section provides for treatment as a business bad debt (deductible in full) of payments made by a taxpayer as a "guarantor, endorser, or indemnitor", but explicitly confines such treatment to the guaranty or indemnity of a "noncorporate obligation". Thus Congress in the 1954 Code not only expressly recognized that losses sustained by "indemnitors"—no less than those sustained by "guarantors"—constitute bad debt losses, but made certain that such losses are subject to capital loss limitations if they result from the payment of a *corporate* obligation by an indemnitor. See also *Putnam, supra,* at pp. 85-86.

The District Court's error is compounded by its misconception of the meaning and scope of the phrase "transaction entered into by an individual for profit", as used in Section 165(c)(2). It mistakenly assumed

that because taxpayers' "motive" in agreeing to indemnify the bonding company was to promote the success of the corporation and thereby enable the taxpayer-husband to realize its profits as sole stockholder and salaried president, the indemnity agreement was a "transaction entered into for profit". Any stockholder-officer who agrees to repay a third party's advances to or on behalf of his corporation, whether in the form of a guaranty or an indemnity agreement, is naturally motivated by a desire to enhance the corporate profits and, consequently, his individual income qua stockholder-employee. But, as the Supreme Court held in *Putnam,* such a transaction is not the kind of "transaction entered into for profit" which Section 165(c)(2) was designed to cover. See also *Whipple v. Commissioner,* 373 U.S. 193. Futhermore, taxpayers could not expect individually to realize a "profit" from their agreement to indemnify the creditors of the corporation; any "profit" from such a "transaction" could be realized only indirectly, through benefits to the borrower corporation, not as indemnitors.

2. Even assuming *arguendo* that the nonbusiness bad debt provisions of Section 166(d) are inapplicable, the decision below should nevertheless be reversed on the alternative ground, also advanced by the Government in the District Court, that a

stockholder's reimbursement payments to a creditor of his corporation under a guaranty or indemnity agreement in substance and effect constitute additional contributions to the capital of the corporation, resulting in a worthless stock loss, and that therefore the capital loss provisions of Section 165(f) and (g) come into play. This Court recently so held (*United States v. Keeler,* 308 F.2d 424, certiorari denied, 373 U.S. 933), pointing out that to accord such loss ordinary loss treatment under Section 165(c)(2) would sanction an unrealistic distinction between a stockholder's direct and indirect investments in the corporation, and thus create a tax loophole never intended by Congress. Other courts have similarly so held.

3. Despite its holding that the payments in question were deductible under Section 165(c)(2) as losses incurred by an individual in a "transaction entered into for profit, though not connected with a trade or business", the District Court inconsistently held—by denying the Government's motion to amend the amount of the judgment—that the losses could be treated as "business" losses for purposes of applying the "net operating loss" carryback provisions of Code Section 172(c) and (d)(4). Those sections permit nonbusiness deductions to be offset only against nonbusiness gross income for purposes of computing a "net operating loss". Accordingly, even if (as the District

Court held) the losses in question were ordinary losses "not connected with [the taxpayers'] business", the amount of the net operating loss carryback allowed by the Court was patently excessive and the Government's motion to reduce the amount of the judgment should have been granted. Of course, if, as we contend, the losses are allowable only as capital losses (i.e. as nonbusiness bad debts under Section 166(d) or, alternatively, as worthless stock investments under Section 165(f) and (g)), the judgment below should be reversed.

ARGUMENT

I

The losses incurred by taxpayers as indemnitors of the corporation's creditor were deductible only as nonbusiness bad debts (capital losses) under Section 166(d) of the Internal Revenue code of 1954, not as ordinary losses under section 165 (c)(2)

A. Introduction

The taxpayer[2], president, director and sole stockholder of a corporation, agreed with his wife to indemnify Bonding Company if it would furnish the requisite performance and payment bonds for the

[2] When used in the singular, taxpayer refers to the husband, Lee Hoffman.

corporation's construction jobs. The corporate venture having proved unsuccessful, taxpayers were obliged under the indemnity agreement to repay Bonding Company for the advances which it had made, and were unable to obtain repayment from the corporation. The immediate question presented is whether taxpayers' loss, resulting from their payment to Bonding Company, is deductible in full under Section 165(c)(2) of the Internal Revenue Code of 1954, (Appendix, *infra*) as a loss incurred in a transaction entered into for profit though not connected with a trade or business, as taxpayers contended and the District Court found, or is it a nonbusiness bad debt loss deductible only as a capital loss under Section 166(d) of the Internal Revenue Code of 1954 (Appendix, *infra*) as the government contended.[8] Upon the determination of that issue hinges the answer to a basic question, namely, whether an investor in an unsuccessful corporate venture is entitled to a greater loss deduction for federal income tax purposes if he agrees to indemnify a third party for advances made to the corporation than if he guarantees repayment of such advances or makes direct loans to the corporation.

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[8] The alternative contention of the United States, i.e., that the losses suffered by taxpayers were losses from the sale or exchange of capital assets within the provisions of Section 165 (f) of the Internal Revenue Code of 1954 will be discussed under Argument II.

The nonbusiness loss suffered by an individual who has lent money to an unsuccessful corporation is treated as a capital loss.[4] The same treatment is given to the nonbusiness loss of an individual who has provided capital for a corporation in the conventional form of purchasing its stock.[5] And, as was recently held by the Supreme Court in *Putnam v. Commissioner*, 352 U.S. 82, the loss incurred by a stockholder as guarantor of loans to his corporation constitutes a nonbusiness bad debt to be treated as a capital loss under Section 166(d).

The District Court, however, in holding for taxpayers, has held that *Putnam* has no application where a contract of indemnity rather than a guarantee agreement is used and that, where an indemnity contract is used, the taxpayer who suffers a loss thereunder is entitled to deduct such loss in full under Section 165(c)(2). The corollary of this holding is that because taxpayer made the necessary operating funds available to the corporation indirectly by agreeing to indemnify Bonding Company, he is entitled to a greater loss deduction than he would have been entitled to had he made the funds available directly, or even in-

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[4] See Section 166(d) and (e), of the Internal Revenue Code of 1954 (Appendix, *infra*).

[5] See Section 165(f) and (g), of the Internal Revenue Code of 1954 (Appendix, *infra*).

directly by means of a guaranty agreement. Yet, as a practical matter, taxpayer's loss would have been precisely the same if he had lent funds directly to the corporation or had guaranteed loans made by other to the corporation.

It is the Government's position that the losses incurred by taxpayers under the indemnity agreement constituted nonbusiness bad debt losses falling within the purview of Section 166(d), and consequently are no less subject to the capital loss limitations imposed by that section than losses resulting from a direct loan or a guaranty of third party loans. To hold that taxpayers are entitled to a greater loss deduction merely because an indemnity contract as opposed to a guaranty agreement was used would exalt form over substance and make the tax result depend upon a distinction having no relation to the business realities of such transaction. Nothing in the relevant statutory provisions or their history justifies the conclusion that Congress intended to create any such distinction; and the court below erred in drawing the distinction.

B. Nonbusiness bad debt losses are deductible as capital losses under Section 166(d), not as ordinary losses under Section 165(c)(2)

Section 166(d) of the Internal Revenue Code of 1954 provides that nonbusiness bad debt losses are to be considered short-terms capital losses.[6]

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[6] SEC. 166. BAD DEBTS.

* * *

(d) *Nonbusiness Debts.*—

(1) *General rule.*—In the case of a taxpayer other than a corporation—

(A) subsection (a) and (c) shall not apply to any nonbusiness debt; and

(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months.

(2) *Nonbusiness debt defined.*—For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than—

(A) [as amended by Sec. 8, Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606] a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

* * *

(26 U.S.C. 1964 ed., Sec. 166.)

The predecessor of Section 166(d), Section 23(k)(4) of the 1939 Code (26 U.S.C. 1952 ed., Sec. 23) was first added to that Code by Section 124(a) of the Revenue Act. of 1942, c. 619, 56 Stat. 798. The purpose of Section 23(k)(4), as stated in the House Ways and Means Committee Report accompanying the 1942 Revenue Bill, was "to remove existing inequities and to improve the procedure through which bad-debt deductions are taken." H. Rep. No. 2333, 77th Cong., 2d Sess., p. 44 (1942-2 Cum. Bull. 372, 408). The effect of Section 23(k)(4) was to subject nonbusiness bad debt losses to the limitations upon capital losses, and thus place them on a tax parity with similar nonbusiness losses which were accorded capital loss treatment.

Prior to the Revenue Act of 1942, in computing an individual's taxable net income, nonbusiness bad debts received more favorable tax treatment than was generally afforded other nonbusiness losses. Thus, an individual's bad debts, whether business or nonbusiness, were deductible in full.[7] On the other hand, only some of an indivdual's nonbusiness losses (other than casuality or theft losses) were deductible, viz., those incurred in transactions entered into for profit.[8]

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[7] See Section 23(k)(1), Internal Revenue Code of 1939 (26 U.S.C. 1940 ed., Sec. 23).

[8] Section 23(e) of the Internal Revenue Code of 1939 (26 U.S.C. 1940 ed., Sec. 23) (predecessor to Section 165(c)(2) of the Internal Revenue Code of 1954).

Moreover, not all deductible losses were fully deductible. A bad debt loss was deductible only as a capital loss if the debt was evidenced by a corporate security, and like treatment was accorded worthless stock losses and losses from sales or exchanges of capital assets.[9]

The Revenue Act of 1942, by restricting the deduction of nonbusiness bad debts, thus brought the tax treatment of those items into closer conformity with that generally afforded an individual's nonbusiness losses. By limiting the bad debts which an individual might deduct as such to business bad debts, and by requiring nonbusiness bad debts to be treated as capital losses, Congress carved out of the general category of losses a particular class of losses, namely, nonbusiness bad debt losses, and expressly subjected them to capital loss limitations—just as it had previously done (in 1939 Code Sections 23 (g) (2) and (3) and (k) (2) and (3)) with respect to debt and stock interests evidenced by securities. Thus under the statutory pattern which emerged from the 1942 amendments, irrespective of whether a nonbusiness bad debt loss might otherwise qualify for deduction in full under the general provisions of Section 165(c)(2), i.e., as a nonbusiness loss incurred in a transaction entered into for profit, such a loss is deductible only as a capital loss by

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[9] See Section 23 (g) (1), (2) and (3) and (k) (2) and (3) of the Internal Revenue Code of 1939 (26 U.S.C. 1940 ed., Sec. 23) (predecessors to Sections 165 (f), (g) and 166 (e)).

virtue of the "special limitation provisions" contained in Section 166(d), not under the "general loss provisions" of Section 165(c)(2), *Putnam v. Commissioner, supra,* pp. 87-88. See also *Spring City Co. v. Commissioner,* 292 U.S. 182.

Accordingly, even assuming, as the District Court held (R. 83), that taxpayers entered into a transaction for profit though not connected with their trade or business when they agreed to indemnify the Bonding Company, the loss resulting from such agreement is nonetheless subject to the capital loss limitations imposed by the special provisions of Section 166(d) if it represented a nonbusiness bad debt loss. Since there can be no question that the loss was of a nonbusiness character,[10] the narrow question which remains—and upon

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[10] As noted above, the District Court found (R.83) that taxpayers' loss was incurred "in a transaction entered into for profit *though not connected with a trade or business.*" (Emphasis supplied.) And, as to the nonbusiness nature of the loss see *Pokress v. Commissioner,* 234 F.2d 146 (C.A. 5th); *Berwind v. Commissioner,* 211 F.2d 575 (C.A. 2d); *Bodzy v. Commissioner,* 321 F.2d 331 (C.A. 5th); *United States v. Byck,* 325 F.2d 551 (C.A. 5th); *Kelly v. Patterson,* 331 F.2d 753 (C.A. 5th); *Pachella's Estate v. Commissioner,* 310 F.2d 815 (C.A. 3d); *United States v. Keeler,* 308 F.2d 424 (C.A. 9th), certiorari denied, 373 U.S. 932.

The test of whether a debt is or is not incurred in a trade or business is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by Section 165(c) is or is not incurred in a trade or business. *Whipple v. Commissioner,* 373 U.S. 193, 200-201; Treasury Regulations on Income Tax (1954 Code), Section 1.166-5(b) (Appendix, *infra*).

which this case turns—is whether the loss was, as the Government contends, a bad debt loss. If it was, then Section 166(d) applies, not Section 165(c)(2), and taxpayers are entitled only to a capital loss deduction.

C. The losses in question were nonbusiness bad debt losses, since taxpayers were subrogated to the rights of the Bonding Company

In holding that a loss incurred by a stockholder under a guaranty agreement is to be treated as a nonbusiness bad debt, the Supreme Court in *Putnam v. Commissioner, supra,* stated (pp. 92-93):

> The loss he sustained when his stock became worthless, as well as the losses from the worthlessness of the loans he made directly to the corporation, would receive capital loss treatment; the 1939 Code [as does the 1954 Code] so provides as to nonbusiness losses both from worthless stock investments and from loans to a corporation, whether or not the loans are evidenced by a security. It is clearly a "fairer reflection" of Putnam's 1948 taxable income to treat the instant loss similarly. There is no real or economic difference between the loss of an investment made in the form of a direct loan to a corporation and one made indirectly in the form of a guaranteed bank loan. The tax consequences should in all reason be the same, and are accomplished by § 23(k)(4) [now 1954 Code § 166 (d)].

The District Court, however, in the instant case, has held the rationale of *Putnam v. Commissioner, supra,* to be inapposite where a contract of indemnity as opposed to a contract of guaranty is involved. (R. 82.) Citing *Howell v. Commissioner,* 69 F.2d 447 (C.A. 8th), certiorari denied, 292 U.S. 654, it based this distinction on the ground that where an indemnity contract is involved, the indemnitor, unlike a guarantor, is not subrogated to the rights of the creditor and thus has no cause of action against the corporate debtor. The District Court further held that, having no right of subrogation, the indemnitors cannot treat the loss as a worthless debt because the corporation would owe them no debt.

Howell v. Commissioner, supra, however, did not restrict an indemnitor in all circumstances from being subrogated to the rights of the indemnitee, for, as the Eighth Circuit there stated (p. 451):

> An indemnitor may, under certain circumstances, by virtue of subrogation, acquire the rights of his indemnitee. 60 C.J. 781; *Jones v. Bacon,* 72 Hun. 506, 25 N.Y.S. 212, affirmed 145 N.Y. 446, 40 N.E. 216.

Whether an indemnitor is subrogated to the rights of the indemnitee thus appears to be determined by the terms of the indemnity agreement and/or whether the agreement is actually one

of indemnity. The Restatement of the Law of Security, Section 82(1), defines "indemnity" as follows:

> 1. *Indemnity.* A contract of indemnity is one where the promisor agrees to save a promisee harmless from some loss, irrespective of the liability of a third person. In this sense, indemnity is synonymous with insurance.

Continuing, the Restatement distinguishes between a contract of indemnity and one of suretyship (guaranty) the former term often being used interchangeably with the latter, although the situation described is the latter. The Restatement states that:

> The indemnitor, upon the happening of the stipulated contingency, is liable whether or not the indemnitee has any recourse against a third person. In suretyship the normal expectation is that the liability will be satisfied by the third person. Indemnity contemplates two parties, at least at the time of making the contract. Suretyship always involves three parties.

Other authorities are to the same effect. For example, Simpson on Suretyship (1950), Section 17, states (pp. 28-29):

> The difference between indemnity and suretyship does not depend upon the use of the word "indemnify" or "guarantee." If C sells goods to P in reliance upon S's promise, whether that promise be in form to "indemnify" C against loss in the event of P's failure to pay, or to "guarantee" C against loss upon

> P's default, in either case S's promise is a promise of guaranty. The real test of a contract of indemnity lies in whether the promisee is an obligee or an obligor, presently or prospectively. If the promise runs to an obligee or to a prospective obligee, as in the above illustration, the contract is guaranty. If the promise runs to an obligor or debtor, the contract is indemnity. For example, if S says to P, "Buy goods from C, and upon your resale of the goods if you suffer loss I will indemnify you," S's contract is a true contract of indemnity.

Simpson, supra, also points out that a situation may occur where there is both a contract of indemnity and of suretyship. For example, if P wishes to borrow from C who refuses to make the loan unless S will guarantee the loan, and S is unwilling to assume the risk of P's insolvency unless T agrees to indemnify or save harmless S from loss on his guarantee, T's contract with S may at once be both indemnity and suretyship, for here T's promisee (S) is both an obligor, as to C, and an obligee, as to P.[11]

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[11] The only importance of distinguishing between a contract of indemnity and of guaranty or suretyship lies in the fact that a contract of guarantee or suretyship is within the Statute of Frauds, whereas a contract of indemnity is not. As for a promise made to a surety or to one about to become a surety to indemnify him against liability or loss arising from his being or becoming a surety, the Restatement of the Law of Security, Section 96 and the Restatement of the Law of Contracts, Section 186, state such promise to be within the Statute of Frauds if at the time when the promise is made or becomes a contract, the principal also is under a duty to indemnify the surety. This statement is based on the ground that where one promises to indemnify a surety, he is promising to answer for the default of the principal in the event of his failure to perform his obligation or his failure to reimburse the surety, if the latter performs the obligation. See Restatement of the Law of Security, Section 96, Comment c.

This Court, in *Atterbury* v. *Carpenter*, 321 F. 2d 921, described the distinction between an indemnitor and a surety as follows. (pp. 923-924):

> Under a contract of indemnity involving only two parties "the promisor agrees to save a promisee harmless from some loss, irrespective of the liability of a third person." Restatement, Security, § 82, comment 1 (1941). The indemnitor's promise is not conditioned upon another's nonperformance of duty." Arant on Suretyship, § 17 (1931). Liability insurance is the typical example.
>
> The surety, however, promises to protect the promisee only in case a third party, who is primarily liable on the obligation, fails to perform. The creditor-promisee is entitled to compensation from the surety only in the event of default by the principal debtor. Restatement, Security, *supra,* comments f and 1; Arant on Suretyship, *supra,* § 17.[12]

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[12] In reversing Chief Judge Solomon of the United States Court for the District of Oregon, this Court stated (p. 924):

> The fact that Atterbury agreed "to insure * * * Carpenter against any loss" is not, as the district court thought, inconsistent with suretyship, for the nature of an insurance contract as one involving indemnity or suretyship depends entirely upon the existence of a third party who is primarily liable to the insured. See generally, Restatement, § 82, comment 1.
>
> The Oregon courts defer to both the Restatement and Arant for the most accurate description of these relationships. See, e.g. *Union Oil Company of California v. Lull* (1960), 220 Or. 412, 425, 349 P. 2d 243, 249.

Howell v. Commissioner, supra, relied upon by the District Court is a classic example of the situation where a true two party indemnity agreement existed. In that case, a bank had acquired certain notes through a firm, the members of which were large stockholders of the bank. Subsequently, members of the firm became involved financially and made an assignment for the benefit of their creditors. Because of the close connection of the firm members with the bank and their financial difficulties, the president of the bank felt that the directors and stockholders should guarantee the bank against loss on the notes. The purpose of the agreement was, as stated by the Eighth Circuit (p. 451):

> * * * to insure the bank to the extent of $200,000 against loss upon the Smith and Ricker paper, and thereby to protect the bank against a possible run and prevent a serious impairment of its assets. There was no intention on the part of the stockholder to acquire the notes or any interest in them or to discharge the obligations of the makers of the notes.

As "neither the bank nor the indemnitors considered that the indemnitors had acquired any interest in these notes by virtue of the payment or that the makers of the notes were obligated to any except the bank" (*Ibid.*), the court held that taxpayer (one of the indemnitors) could not take a

deduction for worthless debts as he did not become a creditor of the makers of the notes.

However, in *Jones v. Bacon,* 145 N.Y. 446, 40 N.E. 216, cited by the Eighth Circuit in *Howell v. Commissioner, supra,* as an example of a situation in which an indemnitor may by virtue of subrogation acquire the rights of his indemnitee, action was brought upon a promise made by defendant's testator to indemnify the plaintiff if he would indorse a note for a third party, which the plaintiff thereupon did.[13] The court there held (pp. 450-451):

> The plaintiff having paid the debt in part out of his property, could, prior to the release, have maintained an action against Kingsbury to recover the sum so paid. (citations omitted). The indemnitor of the plaintiff, on restoring to him this sum in performance of the contract of indemnity, would be entitled to be substituted to the claim of the plaintiff against Kingsbury. This stands upon the most obvious principles of natural justice. The money paid by the plaintiff was at the request of Kingsbury, implied from the legal liability as indorser assumed by him, and Kingsbury was bound

[13] The factual situation of *Jones v. Bacon, supra,* and not that of *Howell v. Commissioner, supra* is analogous to the factual situation presented by the instant case. *Jones v. Bacon,* as does the instant proceeding, presents a legal relationship between the parties more akin to that of suretyship or guaranty than a two party indemnity agreement, and where suretyship is involved there is no question but that the right to subrogation exists. Restatement of Security, Section 141; Simpson on Suretyship, Section 47.

> to reimburse the plaintiff. But, by an independent contract between the plaintiff and his indemnitor, McKechnie, the latter was also bound to save the plaintiff harmless. On performance of this obligation by the indemnitor, he would be entitled to stand in the shoes of the plaintiff as to his right to call upon Kingsbury. * * *

This Court has held likewise in *Reid v. Pauly,* 121 Fed. 652. In that case, indemnitors of sureties on the bond of a contractor for the erection of a county building were compelled to pay judgments against the contractor, who was subsequently declared a bankrupt. This Court there held that the indemnitors were entitled to an equitable lien on a balance due from the county to the bankrupt, which the trustee in bankruptcy subsequently recovered, in the amount of the judgments so paid, stating (p. 657):

> And, as indemnitors of the Washington sureties, the complainants, having paid, under compulsion, the debts for which they were bound, are entitled to subrogation, the same as they would have been had they paid them.

The decision of this Court in *Reid v. Pauly, supra,* has been favorably cited by the Supreme Court of Oregon. *Wasco Co. v. New England E. Ins. Co.,* 88 Ore. 465, 172 Pac. 126.[14]

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[14] On this point see also 60 Corpus Juris 781; Williston on Contracts, Section 1270.

Moreover, the Supreme Court of Oregon (where the instant indemnity agreement was executed) has taken a very liberal view of the right of subrogation. In *United States F. & G. Co. v. Bramwell,* 108 Ore. 261, 277, 217 Pac. 332, 337-338, that court, commenting on the right to subrogation stated:

> It stands upon the same broad principles of natural justice that makes one surety entitled to contribution from another, and is broad enough to cover every instance in which one party is required to pay a debt for which another is primarily answerable, and which, in equity and good conscience, ought to be discharged by the latter. It is a mode which equity adopts to compel the ultimate discharge of a debt by him who in equity and good conscience ought to pay it and relieve him whom none but the creditor could ask to pay, and, when one has been compelled to pay a debt which ought to have been paid by another, he is entitled to exercise all of the remedies which the creditor possesses against that other and to indemnity from the fund out of which should have been made the payment which he has made. The right to be subrogated is not dependent upon legal assignment, nor upon contract, agreement, stipulation or privity between the parties to be affected by it; * * *.

Quoting from *Orem v. Wrightson,* 51 Md. 34, the court continued and stated:

> As is said in some of the cases to which we have referred, equity in applying the doctrine of subrogation looks not to the form, but to the

> substance and essence of the transaction. It looks to the *debt* which is to be paid, and not to the *hand* which may hold it, and will see that the fund charged with its payment shall be so applied.

And in *Hult v. Ebinger,* 222 Ore. 169, 189, 352 P. 2d 583, 592, the Supreme Court of Oregon stated:

> This Court has recognized that the modern tendency is to expand the remedy of subrogation.

See also *Wasco Co. v. New England E. Ins. Co., supra; Barnes v. Eastern & Western Lbr. Co.,* 205 Ore. 553, 287 P. 2d 929; *Fidelity Etc. Co. v. State Bank of Portland,* 117 Ore. 1, 242 Pac. 823; *Schiska v. Schramm,* 151 Ore. 647, 51 P. 2d 668; *Amer. Surety Co. v. Multnomah County,* 171 Ore. 287, 138 P. 2d 597.

Thus, under the decisional law of Oregon and of this Court, taxpayers would be subrogated to the rights of the Bonding Company and the loss which they incurred from entering into the indemnity agreement is limited by Section 166(d) to a nonbusiness bad debt deduction subject to capital loss treatment. *Putnam v. Commissioner,* 352 U.S. 82.

Moreover, to treat taxpayers' loss as a nonbusiness bad debt is in conformity with the manner in which the parties themselves treated the transaction.

First, in the original income tax return filed by taxpayers for the year 1961, they failed to report as salary $11,300 received by them from Lee Hoffman, Inc. (Ex. D attached to defendant's cross motion for summary judgment). It was not until an amended return was filed in conjunction with taxpayers' claim for refund which is the subject of this suit that the amount was reported as salary income. (Compl. Ex. B, R. 13.) Apparently that taxpayers were not attempting to avoid tax by failing to report the $11,300 in their original 1961 return, but were treating it as a nontaxable repayment of an indebtedness owing them by the corporation by virtue of the payment made by them to the Bonding Company under the indemnity and the loan agreements.

Second, on or about November 30, 1962, taxpayers entered into an agreement whereby they were released from all liability to the Bonding Company in consideration for the transfer of certain property to the Bonding Company (Ex. 4 attached to taxpayers' motion for summary judgment). The agreement, in part, provided as follows (p. 1):

> INDEMNITORS are *indebted to BANK and GENERAL as guarantors* of certain obligations of Lee Hoffman, Inc., an Oregon corporation of Beaverton, Oregon, in an aggregate amount in excess of Nine Hundred Thousand and No/100 Dollars ($900,000). This *indebtedness arises out of a guarantee* given

> upon certain notes to BANK, certain agreements of indemnity in favor of GENERAL in connection with bonds of Lee Hoffman, Inc., an agreement dated April 11, 1961 in favor of BANK and GENERAL, and a subsequent agreement dated November 22, 1961 in favor of GENERAL. (Emphasis supplied.)

Although substance, not form, is determinative of the true nature of the agreements entered into by taxpayers, in determining their substance it is relevant to note how the parties themselves ultimately characterized and treated their relationship—as creating an "indebtedness" arising out of a "guarantee."

Third, the agreement of April 11, 1961, between taxpayers, Lee Hoffman, Inc., the Bonding Company and the First National Bank (Ex. 2 attached to taxpayers' motion for summary judgment) and the agreement of November 22, 1961, between taxpayers, Lee Hoffman, Inc., and the Bonding Company (Ex. 3 attached to taxpayers' motion for summary judgment), both referred to above, are reflective of the type of agreement which in *Putnam v. Commissioner, supra,* was held to be one of guarantee (and which gave rise to a nonbusiness bad debt deduction), since they indicate the need of Lee Hoffman, Inc., for additional working capital, taxpayers and the corporation each agreeing to repay the amounts so advanced. For example, the April 11, 1961, agreement provides in part that (pp. 1, 3):

WHEREAS, because of CONTRACTOR'S [corporation's] inability to collect certain accounts receivable which CONTRACTOR feels are due it on account of PROJECTS, CONTRACTOR is unable to continue work on PROJECTS without financial help, and has asked GENERAL [Bonding Company] to assist CONTRACTOR in procuring additional financing to complete the work under said PROJECTS; and

* * *

1. BANK agrees, upon request of GENERAL, to loan CONTRACTOR such amounts, not to exceed in total the sum of $300,000 at any one time ***.

* * *

6. CONTRACTOR and INDEMNITORS agree to repay all sums advanced hereunder, and any and all other sums due GENERAL under this agreement or under any agreement of indemnity * * *.

The District Court was therefore in error in holding *Putnam v. Commissioner, supra,* to be inapposite to the instant proceeding on the theory that taxpayers had no right of subrogation to the claims of the Bonding Company against the corporation.

D. Losses incurred by an indemnitor under an indemnity agreement are nonbusiness bad debt losses even if the indemnitor has no right of subrogation

The essence of the District Court's decision in the instant case is that under Section 166 the Government must look to state law to determine whether or not a debt exists—i.e., whether subrogation would be allowed. We have already shown (Part C, *supra*) that taxpayers had the right to be subrogated to the claims of the Bonding Company. This alone, we submit, demands reversal of the decision below. However, the court below committed reversible error for an additional reason. The equality of treatment to which all taxpayers are entitled is thoroughly disrupted by making the application of any particular section of the federal tax law hinge on the characterization of the transaction under state law. "A cardinal principle of Congress in its tax scheme is uniformity, as far as may be." *United States v. Gilbert Associates,* 345 U.S. 361, 364. As stated by the Supreme Court in *Burnet v. Harmel*, 287 U.S. 103, 110:

> Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution, to tax income. The exertion of that power is not subject to state control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a

> different purpose, is to be interpreted so as to give a uniform application to a nationwide scheme of taxation. See *Weiss v. Wiener,* 279 U.S. 333, 337; *Burk-Waggoner Oil Assn. v. Hopkins,* 269 U.S. 110; *United States v. Childs,* 266 U.S. 304, 309. State law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law. See *Crooks v. Harrelson,* 282 U.S. 55; *Poe v. Seaborn,* 282 U.S. 101; *United States v. Loan & Building Co.,* 278 U.S. 55; *Tyler v. United States,* 281 U.S. 497; see *Von Baumbach v. Sargent Land Co., supra,* 519.

Thus, the determination as to whether a debt exists for purpose of Section 166 should not be a matter controlled by state law.

Moreover, to view the determination as to whether or not a debt exists to be a matter of state law, dependent upon whether the right of subrogation exists, totally disregards the Supreme Court's teaching in *Putnam v. Commissioner, supra,* that the application of the bad debt section does not depend on the mechanics of the transaction. Indeed, the decision of the District Court goes much further than making deductibility hinge on whether a direct loan rather than a guaranty is involved (as was the situation in *Putnam*). Rather, under the District Court's decision deductibility hinges upon the particular type of indemnity, guaranty or suretyship agreement which the taxpayer enters into. Thus, if he acts as a guarantor or as

a surety, and local law provides that such a contract creates subrogation, he would be limited to a capital loss by Section 166(d). On the other hand, if his agreement constitutes him an indemnitor and local law provides no subrogation, he would not be restricted to a capital loss. But, as was recognized in *Putnam v. Commissioner, supra,* the economic impact of what has been done in each situation is the same, i.e., a corporation, short of funds, has had to look to the credit and financial responsibility of its stockholders as a means of obtaining additional funds. Yet, with virtually no difference in substance, radically different tax treatment is afforded the stockholders.

In addition, the District Court's reasoning may well invite attempts by taxpayers to change capital losses into ordinary losses almost at will. Assume for example that in a guaranty agreement such as was used in *Putnam v. Commissioner, supra,* the taxpayer-guarantor waived his right to be subrogated to the claims of the guarantee.[15] As the right to subrogation is usually worthless in these types of cases (*Putnam v. Commissioner, supra,* p. 89),[16] the taxpayer-guarantor would

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[15] See Monkoff, Deductions of Indemnity Losses under Section 165, 50 A.B.A. Jour. 782, 783 (1954) wherein the author advises that no right of subrogation nor possibility thereof, be included in an indemnity agreement.

[16] In many situations where a guaranty agreement is involved, not only is the right of subrogation worthless, but in fact, although the guarantor has the bare legal right to be subrogated to the rights of the guarantee, the principal debtor is

be giving up nothing of value, but, would under the decision of the District Court be able to take an ordinary loss rather than a more limited capital loss as the right of subrogation would be lacking and there would, according to the District Court, be no "debt."

The Government contends therefore that bad debts within Section 166 include not only debts created by direct loans, but by any indirect endorsement or other type of arrangement which creates secondary or primary liability on the part of a corporate stockholder, whether or not the stockholder has the right of subrogation. If such a view is adopted, taxpayers, regardless of the status of local law, will be afforded the same tax treatment irrespective of the secondary methods by which they chose to financially support their corporation.

Section 166 itself supports this argument. As noted previously, Section 166(d) imposes the basic restriction on individual taxpayers with regard to business

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no longer in existence. The Supreme Court, in *Putnam v. Commissioner, supra,* in considering this factor stated (p. 93, fn. 21):

> Upon this ground, contrary to the holding in *Fox v. Commissioner,* 190 F. 2d 101, the guarantor's nonbusiness loss would receive short-term capital loss treatment despite the nonexistence of the debtor at the time of the guarantor's payment to the creditor.

Thus, that the right of subrogation may exist, if at all, in name only demonstrates that the Supreme Court's holding did not depend entirely on the existence of the usually meaningless right of subrogation.

versus nonbusiness bad debts. Although no definition is contained in Section 166(d) of a nonbusiness bad debt, the Congressional intent to preclude deduction in full of losses like that here involved, and to treat them as nonbusiness bad debts, has been confirmed by and carried over into the Internal Revenue Code of 1954. Section 166(f) of the Internal Revenue Code of 1954[17] (Appendix, *infra*) provides for treatment as a business bad debt (i.e., deduction in full) of payments made by a taxpayer as a "guarantor, endorser, or indemnitor," but explicitly confines such treatment to the guarantor, endorser or indemnitor of a "noncorporate obligation." Thus, Congress in the 1954 Code not only expressly recognized that losses sustained by guarantors, endorsers and indemnitors constitute bad debt losses, but made certain that they were subject to capital loss limitations if they resulted from being obligated on a corporate debt. *Putnam v. Commissioner, supra*, p. 86. Moreover, the legislative history of Section 166(f) contradicts the idea that to determine whether or not a debt has been created

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[17] Section 166 (f) provides:

(f) *Guarantor of Certain Noncorporate Obligations.* — A payment by the taxpayer (other than a corporation) in discharge of part or all of his obligation as a guarantor, endorser, or indemnitor of a noncorporate obligation the proceeds of which were used in the trade or business of the borrower shall be treated as a debt becoming worthless within such taxable year for purposes of this section (except that subsection (d) shall not apply), but only if the obligation of the borrower to the person to whom such payment was made was worthless (without regard to such guaranty, endorsement, or indemnity) at the time of such payment.

either the right of subrogation under local law must be examined or else it must be determined whether taxpayer's obligation is "collateral" (a guaranty or endorsement contract) or "direct" (an indemnity agreement). In S. Rep. No. 1622, 83d Cong., 2d Sess., p. 200, 3 U.S.C. Cong. & Adm. News (1954) 4621, 4835, it was stated:

> The term "guarantor, endorser, or indemnitor," includes not only those persons having collateral obligations as guarantors or endorsers but also those persons having direct obligation as indemnitors.
>
> The payment by the taxpayer of such obligation will result in the treatment of such payment as a debt becoming worthless during the taxable year under the general rule of the section and all other rules of the section (other than subsection (d)) become applicable. * * * [i]f the requirements are met, he will obtain a deduction from ordinary income and the nonbusiness bad debt rules of subsection (d) (treating the loss as a short-term capital loss) will not be applicable.

Thus, clearly, Congress considered each of these categories of secondary liability as being the same for purposes of Section 166, and intended that each should be considered as creating a debt for purposes of Section 166(d).

II

Even assuming that code Section 166(d) is inapplicable, the losses would nevertheless be deductible only as capital losses under Section 165(f) and (g), not as ordinary losses under Section 165(c)(2)

Should this Court determine that there was no debt owing to the taxpayers by Lee Hoffman, Inc., and that the loss which taxpayers incurred would therefore not be within Section 166(d), the loss should nevertheless receive capital loss treatment since the sum paid under the indemnity agreement in substance represented contributions to the capital of Lee Hoffman, Inc.

Taxpayers' corporation, as indicated in the loan agreements of April 11, 1961 and November 22, 1961 (Exs. 2 and 3 attached to plaintiffs' motion for summary judgment) was in dire financial condition and lacked the essential working capital to continue operating. The funds advanced first by the bank and later by the Bonding Company, which sums the corporation could not repay, resulted in taxpayers suffering the loss in question when they were called upon to make the loan good.

To hold, however, as did the District Court (R.83), that taxpayers suffered a loss from a transaction entered into for individual profit though not connected with their trade or business within the purview of Section 165(c)(2) requires the finding that taxpayers' "mo-

tive in entering into the transaction was primarily profit." *Helvering v. Nat. Grocery Co.,* 304 U.S. 282, 289; see also *United States v. Keeler,* 308 F.2d 424 (C.A. 9th), certiorari denied, 373 U.S. 932; *Arata v. Commissioner,* 277 F.2d 576 (C.A. 2d). Just how entering into an indemnity agreement obligating taxpayers to furnish money to their corporation or to the Bonding Company as needed for the prompt payment of labor and materials used by the corporation when requested to do so by the Bonding Company (Ex. 1 attached to plaintiffs' motion for summary judgment), and how entering into the loan agreements of April 11, 1961 and November 22, 1961 (Exs. 2 and 3 attached to plaintiffs' motion for summary judgment) by which they obligated themselves, along with their corporation, to repay all sums advanced, is a transaction entered into with a profit motivation is left unexplained by the District Court with the exception of the court's statement that taxpayers "could expect substantial profits if the corporation was successful." (R. 81.) We submit that a stockholder's agreement to advance, or repay sums advanced by another to his corporation, from which transaction itself no profit can be derived, is not a transaction entered into for individual profit within the meaning of Section 165(c) (2).[18] Rather, such an

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[18] *Shea v. Commissioner,* 36 T.C. 577, affirmed, 327 F.2d 1002 (C.A. 5th); *Rietzke v. Commissioner,* 40 T.C. 443, and *Horner v. Commissioner,* 35 T.C. 231, relied upon by the District Court, are factually distinguishable and are inapposite to the situation presented by the instant proceeding.

agreement represents a capital contribution to the corporate entity, deductible only as a capital loss within the provisions of Section 165(f) and (g) (Appendix, *infra*) when the stock becomes worthless and the agreement is perfomed.[19]

That an indemnity, guaranty or endorsement agreement may be entered into with the intention of preserving or increasing the value of a prior investment, and that it should therefore be treated as a capital contribution, has long been recognized. *Burnet v. Clark,* 287 U.S. 410; *Menihan v. Commissioner,* 79 F.2d 304 (C.A. 2d); *Syer v. United States* (C.A. 4th), decided July 5, 1967 (20 A.F.T.R. 2d 5252); *In re Park's Estate,* 58 F.2d 965 (C.A. 2d); *Estate of McGlothlin v. Commissioner,* 370 F.2d 729 (C.A. 4th). As stated by the Fourth Circuit in *Syer v. United States,*[20] *supra* (p. 5255):

> If the business had prospered and the taxpayer had sold his stock for a profit, he would have reported his profit as a capital gain. A loss

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[19] The District Court, in rejecting the applicability of Section 165(f) and (g), stated that Section 165(f) applies only to losses from sales or exchanges of capital assets and that here "there was no 'sale or exchange'." (R. 83.) For Section 165(f) and (g) to be applicable there need not be an actual sale or exchange. See *United States v. Keeler, supra.* And see Treasury Regulations on Income Tax, Section 1.165-5(c) (Appendix, *infra*).

[20] In *Syer,* taxpayer, as a condition to purchasing 49 percent of a corporation's stock, was required to guaranty certain loans and was subsequently called upon to pay the loans under the terms of the guaranty.

> should receive the same treatment. While the losses sought to be deducted were occasioned immediately by his guaranty of the bank loans, his lending his credit was, in every sense, a part of his cost of acquiring the stock.

This Court has recently been confronted with the problem of determining whether a loss under a guaranty agreement was deductible as an ordinary loss under Section 165(c) (2) or as a capital loss under Section 165(f). In *United States v. Keeler, supra,* the taxpayer induced a group of persons (referred to as the Hooker group) to purchase stock in a corporation, in which he held approximately an one-sixth interest, by orally promising to reimburse the group for any loss which they might sustain by reason of their investment. The taxpayer there, as do the taxpayers here, attempted to deduct the resultant loss as one arising from a transaction entered into for profit.[21] The District Court held that the loss should be "treated as a loss upon the purchase of stock," and this Court affirmed, stating (p. 433):

> Considering only the guaranty to the Hooker group as the "transaction" involved in this question, it is clear that the guaranty was not "a transaction entered into for profit" within the meaning of the statute. Under the guarantee, the best taxpayer could hope for was that he would not sustain a loss.***

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[21] Taxpayer in *United States v. Keeler,* also made the alternate contention that the loss was incurred in a trade or business, deductible in full under Section 165(c) (1).

> However, taxpayer contends that the "transaction" to be considered involves his entering into the creation of Northern, from which he hoped to derive a profit, and that the guaranty of the Hooker group's investment in Northern was an integral part of the entire transaction. Assuming this to be true, the profit which taxpayer could hope to realize would lie in the increased value of his investment in Northern, and possibly greater dividends from that investment.

In holding that the loss was deductible only as a capital loss, this Court reasoned as follows (p. 434):

> Now, it is absolutely clear that had the Hooker group sold their stock at a loss and remained unreimbursed, they would have been entitled only to a capital loss deduction for such loss because of Sec. 165(f). Certainly, when the loss passed to taxpayer by virtue of the guaranty agreement, he should be entitled to no more favorable consideration than the original losers. If the guaranty was made to the Hooker group by the taxpayer as a transaction entered into for profit (and it must be regarded as such if taxpayer is to receive any deduction at all for the resultant loss), then it must be regarded as an investment, and the resulting loss must be treated as a loss on investment. Had taxpayer chosen to make his investment by direct purchase of stock, the resultant loss would be a capital loss under 165(f); had he made his investment in the form of a direct loan to the corporation, or by guaranteeing bank loans to the corporation, the loss would have been a nonbusiness bad debt deductible as a capital loss under Sec. 166(d). To hold

> that he is entitled to more favorable treatment because he chose to make his investment in the manner he did, would be entirely unrealistic, and would create a tax loophole that was never intended by Congress. The case of *Putnam v. Commissioner, supra,* supports this reasoning.

The same reasoning is applicable to the present situation. See also *Estate of McGlothlin v. Commissioner, supra.*

III

Even assuming that the District Court's decision is correct, it erred in denying the Government's motion to reduce the amount of the judgment

On March 21, 1967, the District Court entered judgment in favor of taxpayers in the amount of $9,345.61 (R. 84), which was based on the assumption that the losses in question could be carried back to prior years under the provisions of Section 172 of the Internal Revenue Code of 1954 (Appendix, *infra*). Subsequent to the filing of its notice of appeal, the Government moved to amend the judgment award from $9,345.61 to $1,812.01 on the ground that deductions not attributable to a taxpayer's trade or business cannot be carried back to prior years. This motion was denied. (R. 92.)[22] We submit that, even as-

[22] The judgment was entered shortly after the opinion was filed, before the Internal Revenue Service was afforded an opportunity to submit its computation of the amount due under the

suming *arguendo* (as the District Court held) that the losses in question fall within Code Section 165(c)(2), i.e., were incurred in a "transaction entered into for profit, though not connected with a trade or business", the District Court erred in granting judgment to taxpayers in the amount of $9,345.61 and in failing to grant the Government's motion to reduce the amount of the judgment, since the losses cannot under Section 172 of the Internal Revenue Code of 1954 be carried back to prior tax years.

The excess of deductions over gross income for one tax year cannot be carried back and deducted from income of prior years as a matter of right. A loss incurred in one tax year is set off only against income for that year unless Section 172 authorizes the net operating loss to be carried back. See *Libson Shops, Inc. v. Koehler,* 353 U.S. 382. Section 172(c) (Appendix, *infra*) provides that:

> For purposes of this section, the term "net operating loss" means *** the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modification specified in subsection (d).

---

court's ruling. In summarily denying the Government's motion to amend the amount of the judgment, the court suggested that the issue could be raised on appeal, and stated (transcript of Hearing on Motion to Amend Judgment, July 24, 1967):

> I have been reversed before by the Court of Appeals. I am going to deny your motion and let the Court of Appeals reverse me. Tell them to raise it in the Court of Appeals.

Section 172(d) (4) (Appendix, *infra*) in turn states that:

> In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to to the extent of the amount of the gross income not derived from such trade or business.

Thus, in the determining the net operating loss carryback the ordinary deductions allowed under the 1954 Code which are not attributable to the taxpayer's business can be taken into account only to the extent of the ordinary gross income not derived from the business. See also Treasury Regulations on Income Tax (1954 Code), Section 1.172-3(a)(3)(i) (Appendix, *infra*); 5 Mertens, Law of Federal Income Taxation, Section 29.02(b).

In holding for taxpayers, the District Court ruled (R. 83) "that the Hoffmans incurred a loss in a transaction entered into for profit though not connected with their trade or business." Accordingly, even under the court's own holding, the losses in question constituted nonbusiness deductions which could be used only to offset taxpayers' nonbusiness income, not their business income, for purposes of computing a "net operating loss" which could be carried back and offset against income of prior taxable years. The judgment below disregarded the provisions of Section 172, and improperly allowed such a carryback to prior years

(1958-61), resulting in an excessive amount of refund awarded to taxpayers.[23]

[23] If the court agrees with our contention (Points I and II, *supra*) that the losses in question do not represent ordinary losses falling within Section 165 (c) (2), but are capital losses, the issue raised by the motion to amend the amount of the judgment is academic, since the judgment should then be reversed.

CONCLUSION

The decision of the District Court is erroneous and should be reversed. Alternatively, if the decision of the District Court is upheld, the amount of the judgment awarded taxpayers should be reduced from $9,345.61 to $1,812.01.

Respectfully submitted,

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OCTOBER, 1967

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: 24th day of October, 1967.

SIDNEY I. LEZAK,
United States Attorney

APPENDIX

Internal Revenue Code of 1954:

SEC. 165. LOSSES.

* * *

(c) *Limitation on Losses of Individuals.*—In the case of an individual, the deduction under subsection (a) shall be limited to—

* * *

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

* * *

(f) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212.

(g) *Worthless Securities.*—

(1) *General rule.*—If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.

(2) *Security defined.*—For purposes of this subsection, the term "security" means—

(A) a share of stock in a corporation;

* * *

(26 U.S.C. 1964 ed., Sec. 165.)

SEC. 166. BAD DEBTS.

* * *

(d) *Nonbusiness Debts.*—

(1) *General rule.*—In the case of a taxpayer other than a corporation—

(A) subsections (a) and (c) shall not apply to any nonbusiness debt; and

(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months.

(2) *Nonbusiness debt defined.*—For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than—

(A) [as amended by Sec. 8, Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606] a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

(e) *Worthless Securities.*—This section shall not apply to a debt which is evidenced by a security as defined in section 165(g) (2) (C).

(f) *Guarantor of Certain Noncorporate Obligations.*—A payment by the taxpayer (other than a corporation) in discharge of part or all of his obligation as a guarantor, endorser, or indemnitor of a noncorporate obligation the proceeds of which were used in the trade or business of the borrower shall be treated as a debt becoming worthless within such taxable year for purposes of this section (except that subsection (d) shall not apply), but only if the obligation of the borrower to the person to whom such payment was made was worthless (without regard to such guaranty, endorsement, or indemnity) at the time of such payment.

* * *

(26 U.S.C. 1964 ed., Sec. 166.)

SEC. 172. NET OPERATING LOSS DEDUCTION.

* * *

(c) *Net Operating Loss Defined.*—For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) *Modifications.*—The modifications referred to in this section are as follows:

* * *

(4) *Nonbusiness deductions of taxpayers other than corporations.*—In the case of a taxpayer other than a corporation, the deductions

allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

(A) any gain or loss from the sale or other disposition of—

(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

(ii) real property used in the trade or business, shall be treated as attributable to the trade or business;

(B) the modifications specified in paragraphs (1), (2) (B), and (3) shall be taken into account; and

(C) any deduction allowable under section 165(c) (3) (relating to casuality losses) shall not be taken into account.

* * *

(26 U.S.C. 1964 ed., Sec. 172.)

Treasury Regulations on Income Tax (1954):

§ 1.165-5 Worthless securities.

* * *

(c) *Capital loss.* If any security which is a capital asset becomes wholly worthless at any time during the taxable year, the loss resulting there-

from may be deducted under section 165(a) but only as though it were a loss from a sale or exchange, on the last day of the taxable year, of a capital asset. See section 165(g) (1). The amount so allowed as a deduction shall be subject to the limitations upon capital losses described in paragraph (c) (3) of § 1.165-1.

* * *

(26 C.F.R., Sec. 1.165-5)

§ 1.166-5 *Nonbusiness debts.*

* * *

(b) *Nonbusiness debt defined.* For purposes of section 166 and this section, a nonbusiness debt is any debt other than—

(1) A debt which is created, or acquired, in the course of a trade or business of the taxpayer, determined without regard to the relationship of the debt to a trade or business of the taxpayer at the time when the debt becomes worthless; or

(2) A debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

The question whether a debt is a nonbusiness debt is a question of fact in each particular case. The determination of whether the loss on a debt's becoming worthless has been incurred in a trade or business of the taxpayer shall, for this purpose, be made in substantially the same manner for determining whether a loss has been incurred in

a trade or business for purposes of section 165(c)(1). For purposes of subparagraph (2) of this paragraph, the character of the debt is to be determined by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt comes within the exception provided by that subparagraph. The use to which the borrowed funds are put by the debtor is of no consequence in making a determination under this paragraph. For purposes of section 166 and this section, a nonbusiness debt does not include a debt described in section 165(g)(2)(C). See § 1.165-5, relating to losses on worthless securities.

* * *

(26 C.F.R., Sec. 1.166-5.)

§ 1.172-3 *Net operating loss in case of a taxpayer other than a corporation.*

(a) *Modification of deductions.* A net operating loss is sustained by a taxpayer other than a corporation in any taxable year beginning after December 31, 1953 if and to the extent that, for such year there is an excess of deductions allowed by chapter 1 of the Internal Revenue Code of 1954 over gross income computed thereunder; this rule shall apply even though the loss year is otherwise subject to the Internal Revenue Code of 1939. In determining the excess of deductions over gross income for such purpose—

* * *

(3) *Nonbusiness deductions*—(i) *Ordinary deductions.* Ordinary nonbusiness deductions shall be taken into account without regard to the amount of business deductions and shall be allowed in full to the extent, but not in excess, of that amount which is the sum of the ordinary nonbusiness gross income and the excess of nonbusiness capital gains over nonbusiness capital losses. See paragraph (c) of this section. For purposes of section 172, nonbusiness deductions and income which are not attributable to, or derived from, a taxpayer's trade or business. Wages and salary constitute income attributable to the taxpayer's trade or business for such purposes.

* * *

(26 C.F.R., Sec. 1.172-3.)

No. 22093

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

LEE HOFFMAN and JUDY HOFFMAN,
husband and wife,

Appellees.

FILED

JAN 26 1968

WM. B. LUCK, CLERK

BRIEF OF APPELLEES

Appeal from the United States District
Court for the District of Oregon

Honorable Gus J. Solomon, District Judge

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Mankoff, Raymond M. "Deduction of Indemnity Losses Under § 165", 50 A.B.A.J. 783 (1964). 20

5 Mertons, Law of Federal Income Taxation, § 29.06, p. 71 39

No. 22093

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

LEE HOFFMAN and JUDY HOFFMAN,
husband and wife,

Appellees.

BRIEF OF APPELLEES

Appeal from the United States District Court
for the District of Oregon

OPINION, BELOW, JURISDICTION, QUESTIONS PRESENTED, AND STATUTES AND REGULATIONS INVOLVED.

Appellees accept appellant's statement of opinion below, jurisdiction, questions presented, and statutes and regulations involved, as expanded by a more extensive statement of the case, infra. Pertinent statutory and regulatory material is presented in Appendix A, infra.

STATEMENT OF THE CASE

Simplification and solution of the issues presented demand a more complete statement of the case.

Three sections of the Internal Revenue labyrinth are pertinent: 26 U.S.C. §§ 165, 166 and 172 (hereinafter sometimes referred to for sake of brevity variously as "§ 165," "§ 166," and "§ 172").

Section 165 considers "losses." Any loss uncompensated by insurance is deductible, 26 U.S.C. § 165(a), to the extent of the taxpayer's adjusted basis, 26 U.S.C. § 165(b). However, § 165(c) limits loss deductions for individuals to (1) losses incurred in a trade or business; (2) losses incurred in transactions entered for profit, unconnected with a trade or business; and (3) casualty losses exceeding $100. Capital losses and losse from worthless securities are limited to the amount of the applicable capital gain and $1,000, 26 U.S.C. § 165(f), (g).

Section 166 is concerned with "bad debts." Bad debts are generally deductible; however, for an individual taxpayer, no bad debt deduction is allowed for nonbusiness debts in excess of capital gains plus $1,000. 26 U.S.C. § 166(a), (b), (d) (1). A "nonbusiness bad debt" is defined as a debt which is not create or acquired in connection with, or incurred in, the taxpayer's trade or business.

Section 172 deals with net operating loss deductions. It is an ameliorative section allowing carry-back and carry-

over of excess of deductions over income, across lines of accounting periods. Section 172 (d)(4) provides that an individual taxpayer's deductions which are not attributable to his trade or business will be allowed only to the extent of his gross income not derived from his trade or business.

The instant transactions must be considered in connection with these sections. Taxpayers timely filed an action for refund of $9,345.61, representing overpayments of federal income taxes for the tax years 1958 through 1961, inclusive. (R. 1-22, 78-79.) Taxpayers' action was premised upon refund claims (R. 5-22, see Ex. "A", "B", "C", "D" and "E" to complaint) which were rejected [except for a portion of the 1961 refund claim in the amount of $243.99 (R. 3)], by the Internal Revenue Service. In denying the refund claims, the Government disallowed taxpayers' claimed loss deduction except for the extent of $1,000, plus applicable capital gains, and contended that the losses were capital losses (R. 3; admitted, R. 24).

Taxpayer Lee Hoffman operated a highly successful contracting business prior to 1958 as a sole proprietor (R. 29, 111-121). At that time, he organized Lee Hoffman, Inc., (the "corporation" per Br. 5); Mr. Hoffman was president, director and sole stockholder; he received a salary for his efforts as president (Br. 5; R. 5-22, 79).

On June 15, 1958, the taxpayers, the corporation and the General Insurance Company of America ("bonding company" in the Government's brief and hereinafter referred to as "General"),

entered into an agreement (R. 34-37). The contract was in the standard form used by surety companies from time immemorial. There was no evidence of any negotiated provisions on behalf of the taxpayers or the corporation. In this sense, it was a "contract of adhesion."

The agreement with General provided, inter alia, that General would furnish performance and payment bonds; in return, the taxpayers individually agreed to indemnify General for any losses which might arise out of, or on account of, the execution of such bond. (See e.g., R. 34-37, confirm R. 79-80).

Bonding requirements for construction contracts are virtually universal, due in no small part to the infusion of federal, state and local governmental money into almost all construction projects, both "public" and "private".

Realistically, a contractor cannot secure the necessary payment and performance bonds without execution of an indemnity agreement resembling the documents here entered. (See R. 30.)

On September 9, 1959, the corporation entered into a contract with Oak Lodge Sanitary District No. 1, for the construction of a sanitary sewer system in the gross amount of $2,122,881.75, and General provided the payment and performance bonds required by Oregon law, pursuant to the parties' agreement. (R. 30-31, confirm, R. 80.) On July 20, 1960, the corporation entered into a second contract with Oak Lodge Sanitary District No. 2, for the construction of a sanitary sewer system in the gross sum of $1,294,243; likewise, General provided payment and

performance bonds. (R. 31; confirm R. 80.)

The corporation suffered financial reverses. On April 11, 1961, an agreement was entered into between the corporation, General, The First National Bank of Oregon (hereinafter referred to as "Bank") as a conduit, and taxpayers as indemnitors. (R. 31, 38-53.)

On April 21, 1961, taxpayers sold real property subject to the foregoing agreement, and the net proceeds ($20,400.83) were transferred to General in conformity with the indemnity agreement. (R. 31, 80.)

Thereafter, on November 20, 1961, the agreement of April 11 was terminated and General paid the bank the sum of $500,199.81, pursuant to Paragraph 7 (R. 40); this amount represented the monies advanced to fund the completion and performance of the two contracts. (In large part, the funds were utilized to discharge claims such as mechanics' liens). This sum reflected as credits all payments previously received from the individual indemnitors and the corporation. (R. 31-32.)

A new agreement was entered November 22, 1961, which eliminated the Bank as conduit for the funds (R. 32, 54-57). This contract provided that General was to advance the corporatio the amounts necessary to complete the contracts, and the corporation and the indemnitors agreed to repay General on demand for all advances, including monies advanced under the prior agreement and the agreement of indemnity dated June 15, 1958. The agreement specifically provided that it was not to limit or

modify any rights existing under the prior agreement. (R. 57.)

On November 30, 1962, a release and settlement agreement was entered into between the bank, General and taxpayer Judith Hoffman for herself individually and as guardian of the estate of taxpayer Lee H. Hoffman, an incompetent (R. 58-68). Prior to November 30, 1962, taxpayers liquidated certain common stocks and paid the proceeds to General. The basis of this property for federal income tax purposes was $2,740. On November 30, 1962, taxpayers transferred cash, stock and real property to General for a full and complete release of all liabilities to General, which the Court found at that time exceeded $900,000 (R. 58, 80-81.) The basis of this property in the hands of taxpayers was $56,223.40 (R. 32-33). The property so transferred had a value in excess of the basis, but less than the amount of the debt to General. Provision 3 of the release and settlement agreement provided:

> "INDEMNITORS warrant and affirm that they have made a full disclosure of all of their assets, and that in addition to the assets described in Schedules A and B the only property owned by INDEMNITORS is that described in Schedule C hereto attached, which Schedule is made a part of this paragraph as fully as though set forth completely herein. In the event that it is discovered at any time that any property has been omitted from Schedules A, B and C, INDEMNITORS agree to convey the same to BANK, and GENERAL immediately." (R. 59). /Emphasis in original./

Indemnitors conveyed, inter alia, pursuant to Schedule A (R. 63-64), a portion of taxpayer Lee Hoffman's birthright:

> "Two-thirds of the one-fourth contingent remainder interest of Lee H. Hoffman in and to the trust

estate created by the will of the late Lee Hawley Hoffman, father of Lee H. Hoffman by which the remainder of the estate of Lee Hawley Hoffman, deceased, was conveyed in trust to Eric Hoffman and Walter Burns Hoffman as trustees, which remainder interest is subject to a life estate in said trust property for Carolyn Couch Hoffman, the mother of Lee H. Hoffman, and said contingent remainder interest is to vest in Lee H. Hoffman in the event that he survives his mother, all as in the will of Lee Hawley Hoffman set forth and probated in the Circuit Court of the State of Oregon for the County of Multnomah under Cause No. 84008."

Timely refund claims were filed by taxpayers with the Internal Revenue Service for tax years 1958-1961, inclusive. Taxpayers asserted that the amounts paid to General, pursuant to the foregoing agreements, were deductible as "ordinary losses" which could be "carried back"; they deducted their basis for the property included in the payments and listed them as "loss-payment to General Insurance Company under Indemnity Agreement" (R. 7, 9, 15). The Internal Revenue Service rejected these refund claims, contending that the losses were capital losses (R. 3, 24).

Taxpayers' timely complaint for refund (R. 1, et seq), was answered by the Government (R. 23-24). Thereafter, taxpayers moved for summary judgment pursuant to Rule 56, Fed. R. Civ. Pr., 28 U.S.C. (R. 25), supported by appropriate memoranda (R. 26-28), affidavits, and incorporated documents (R. 29-67). All facts were admitted by the Government at this stage (e.g., Tr. 37; R. 24, 100, 102).

The Government moved to deny taxpayers' motion for summary judgment and filed a cross-motion for summary judgment

(R. 69). The Court entered judgment for the taxpayers (R. 84) on March 21, 1967, premised upon the opinion and order of the Honorable Gus J. Solomon, Chief Judge of the United States District Court for the District of Oregon (R. 78-83). The Court considered the issues as if a trial were had on the merits on stipulated facts, not on the respective motions for summary judgment (Tr. 37; R. 83). On May 16, 1967, the Government filed its notice of appeal (R. 85). On June 20, 1967, the Government, unopposed, was permitted to extend the time permitted to docket the record on appeal for the full 90 days (R. 86).

Long after entry of judgment and filing of notice of appeal, the Government sought to amend judgment (Tr. 87-88); the motion to amend was filed and served July 10, 1967 (R. 147). The motion to amend was denied (Tr. 92).

SUMMARY OF ARGUMENT

The losses incurred by the taxpayers as indemnitors of General are deductible as "ordinary losses" pursuant to 26 U.S.C. § 165(c).

Taxpayers' losses were not "nonbusiness bad debts" under 26 U.S.C. § 166(d). Plaintiffs reserved no right of subrogation in their indemnity contract, and the parties' intent militates against retention of such a right, particularly where all assets, including all of the corporation's stock, was transferred to General.

Assuming, arguendo, that some implied right to subro-

gation could be available to an indemnitor, that right did not exist under the admitted facts. A party is not entitled to split his cause of action, and taxpayers failed to discharge the entire debt, which exceeded $900,000. Since taxpayers did not liquidate the complete debt, they possessed no right of subrogation.

Moreover, taxpayers and General entered into a release and compromise as to all claims against both taxpayers and their corporation in November, 1962. When a claim is compromised, the promisor retains no subrogation rights.

Losses sustained by an indemnitor pursuant to an indemnit agreement are ordinary losses; they cannot be tortured into "non-business bad debts" where, as here, the indemnitor has no right of subrogation. Any lack of uniformity posited by the Government because of this rule, derives from artifical administrative and judicial distinctions; there is no reason to thwart a taxpayer's right to ordinary-loss treatment by administrative fiat here where the taxpayer clearly comes within the ambit of the statute.

Taxpayers' losses are not capital losses under 26 U.S.C. § 165(f), (g). Any contention that payments by taxpayers to General pursuant to the compulsion of the indemnity agreement constituted contributions to capital is patently ludicrous.

The district court properly denied the Government's motion to reduce judgment. The motion was untimely filed and served; indeed, the motion was filed 111 days after the judgment

was entered, and 55 days after the Government filed notice of appeal (R. 84, 85, 87-88, 147). While the motion and supporting documents omitted the date (R. 87-88), the record clearly sustains taxpayers' contention of untimeliness (R. 92, 147). Footnote 22 (Br. 48-89) is a specious excuse. If the Government is held to some modicum of fairness, it is not free to reopen that which has been settled and admitted.[1]

Moreover, taxpayers were relieved of any obligation to submit evidence on the "trade or business" issue by reason of the Government's judicial admissions.

Finally, there was evidence (from the admitted facts) that the taxpayer was engaged in the trade or business of rendering managerial and other services to the corporation, and that the furnishing of the indemnity agreement was done in connection with such a trade or business. The Government is barred and estopped from raising this issue in light of its conduct, judicial admissions, and untimely action. The judgment of the district court should be affirmed.

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[1] It should be noted that the government cites the transcript of the hearing on the motion without designating the transcript as part of the record on appeal. The Government's motion to amend was not "summarily" denied, but was denied fifteen days after it was filed and only after both parties had submitted written briefs in support of their positions. (R. 89, 92, 146).

ARGUMENT

I.

Taxpayers-Plaintiffs' Losses Were "Ordinary Losses," Fully Deductible Under 26 U.S.C. § 165(c)

Taxpayers made payments to General under their direct obligation contained in the indemnity agreement. As the result, taxpayers suffered deductible "ordinary losses." 26 U.S.C. §165.

Any tiresome commentary concerning bad debts, business or nonbusiness in character, asserts interesting trivia, wholly irrelevant to this case. It is sufficiently difficult to comprehend the tortured theorizing of Putnam and its progeny [Putnam v. Commissioner of Internal Revenue, 352 U.S. 82 (1956)], wherein an ordinary loss transaction (at least a transaction so conceived by the common taxpayer) is painfully ensconced in the Procrustean bed of "bad debts." If this Court chooses to adopt the Government's position, the law will be encrusted with an additional anomaly. If deductions for ordinary losses should be limited in scope (the apparent major premise of the Government's arguments), should not the power of change reside in Congress instead of interested administrative advocates?

Appellant renders the issue unnecessarily complex. Taxpayers suffered a loss by any rational standard. The bad-debt provisions of the Code are irrelevant. The sole issue, then, is whether the loss was "an ordinary loss" or "a capital loss." The Government's argument on this point[2] is easily reduced to

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2 See Government's argument II, Br. 43-47, answered more specifically in II, infra.

absurdity. Therefore, the district court properly applied 26 U.S.C. § 165 to the case at bar. The decision was clearly correct and should be upheld. The Court's findings are presumptively valid and will be sustained unless found to be clearly erroneous. See, e.g., Rule 52, Fed. R. Civ. Pr., 28 U.S.C.; Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278 (1960); McAllister v. United States, 348 U.S. 19 (1954); United States v. Gypsum Company, 333 U.S. 364, [rehearing denied 333 U.S. 869 (1948)].

A. Introduction

The governmental assertion of unnecessary issues requires a more lengthy reply by taxpayers, in order to avoid apparent acceptance of invalid arguments by failure to comment. Insofar as desirable, taxpayers will follow the appellant's division of argument.

Appellant's "Introduction" (Br. 16-19) contains several statements materially erroneous:

(1) The Government asserts that the taxpayers paid General pursuant to its direct indemnity obligation "and were unable to obtain repayment from the corporation" (Br. 17). This error, repeated in various forms throughout appellant's brief, betrays the Government's confused analysis of the total transaction. Taxpayers were either entitled to subrogation against the corporation, or not, as a matter of law; no factual question is presented. If there exists no right of subrogation, a party cannot voluntarily relinquish such a nonexistent right

(apparently this is the Government's position in one of its several guises). Here, the taxpayers made no attempt to claim against the corporation --they possessed no right or basis to do so.

It is patently ridiculous to claim that taxpayers relinquished a right not owned or possessed. Such a claim would necessarily assume the control and ownership of the subrogee. Here, taxpayers transferred their entire fortune, including all shares of stock in the corporation, to General (R. 58-68). Taxpayers and General, dealing at arms' length, entered into a business transaction. One can hardly suppose that General intended to have that bargain undercut by taxpayers' assertion of a right of subrogation against some of its assets. Taxpayers did nothing voluntarily; certainly they paid no debts or infused no capital into the failing corporation at the time the agreements were executed. No rational person would make any additional commitment of capital to this unhealthy enterprise subsequent to its insolvency.

Moreover, the obvious intent of the release (R. 58-67) was to permit General to take all of the meat from the corporate bones; how does appellant, so fixed upon "realities," believe that this bargain reserved an unimpaired right to subrogation?

(2) The Government states the question to be whether the loss is a nonbusiness bad debt loss or a loss fully deductible under 26 U.S.C. § 165(c)(2) "as a loss incurred in a transaction entered into for profit though not connected with a trade or business, as taxpayers contended" (Br. 17) (Emphasis added).

The record does not reflect a basis for this statement although the transcript, not a part of the record, might do so. 26 U.S.C. § 165(c) permits ordinary loss treatment to (1) losses incurred in a trade or business; (2) losses incurred in a transaction entered into for profit, unconnected with a trade or business; (3) casualty losses exceeding $100, unconnected with a trade or business. Taxpayers did not specify in their refund claims or complaint that the loss fell within a specific subsection of § 165.

The refund claims of taxpayers asserted the right to carry back losses from 1961 and 1962 for "Payment(s) to General Insurance Company under Indemnity Agreement". The government's position through judgment was consistently that the loss was a capital loss because it was a bad debt or a contribution to capital. Each party filed a motion for summary judgment asserting that no issue of fact remained for the court. The parties agreed that these motions could be considered by the court as a pre-trial order setting forth the respective contentions.[3] At this stage it was truly irrelevant whether tax-

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[3] "Mr. Moore: Your Honor, there is one thing we do agree on, if the Court should, after going over the documents in the case, decide that it wishes additional evidence or affidavits or any additional testimony on any factual issue, we would like to treat the motion for summary judgment as a pretrial order and limit the issues as much as possible. I don't think that's the case.

Mr. Smith: This is agreeable to us, your Honor." (Tr. 36-37)

payers relied on § 165(c)(1) or § 165(c)(2) since the Government had never asserted § 172(d)(4) as a partial defense. It was only 111 days after the court, in reliance upon the contentions of the parties, entered its decision and judgment that the Government suggested that a portion of taxpayers' loss could not be carried back.

Conceptually, taxpayers suffered the loss in their trade or business. The admitted facts indicate that taxpayer Lee Hoffman was engaged in the trade or business of rendering managerial and other services to the corporation, and that the furnishing of the indemnity agreement was performed in connection with such a trade or business. Taxpayer was the salaried president of the corporation, and anticipated payment for services if the enterprise was successful. The corporation was unable to bid on public contracts without bonding capacity, and could not obtain satisfactory bonding power without the indemnity agreement of the taxpayer.[4]

(3) Appellant makes the unreasonable assertion[5] that taxpayers advanced funds for necessary operating capital via the agreement with General and in some manner secured a "tax break" unavailable to ordinary mortals (see, e.g., Br. 17-19). No one

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[4] See Argument III, infra, for further comment. Admittedly, after the stipulations by Government foreclosed any inquiry as to carryback, the taxpayers' counsel asserted the claim and argument under 26 U.S.C. § 165(c)(2) (e.g., Tr. 19, 20, 30). However, taxpayers have no compunction about advancing additional theories since the Government feels free to reopen foreclosed contentions (Br. 48, et seq; see Argument III, infra).

[5] Repeated in various guises throughout the appellant's brief.

advanced funds to the corporation. General invested no capital in the corporation; its payments liquidated only existing claims arising out of the Oak Lodge contracts, such as mechanics' and materialmen's liens--for this was its obligation under its bonds furnished pursuant to the Oregon statute. To make the argument serves only to waste time and temper. The indemnity agreement (R. 34-37) was executed June 15, 1958. The corporation was formed shortly prior thereto. The corporation needed no funds in 1958; it was adequately capitalized. No one foresaw the future financial predicament when the indemnity agreement was executed. Can it be earnestly contended that taxpayers intended to use this method to secure capital contributions? Would the taxpayers have entered this agreement in 1958 if they had known that in five years it would cost them their entire fortune? The mind boggles at such a prospect.

The Government appears to believe that all agreements were executed contemporaneously; it was almost three years after the execution of the indemnity agreement that the first loan agreement was executed under the compulsion of the indemnity contract.[6] One year later, November 30, 1962, the release between taxpayers and General was executed (R. 58-67). As indicate infra, it is absurd to contend that any rational being would make a "capital investment" in the corporation in 1961. The taxpayers lost their personal fortune only because they were

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[6] The agreement of April 11, 1961, appears at R. 38-53; the agreement of November 22, 1961, appears at R. 54-57.

required to execute the indemnity agreement. No one would have invested risk capital in the corporation in 1961 or 1962 at a time when the corporation was unable to pay more than $500,000 in obligations.

(4) Finally, the Government says that the taxpayers' position is unrealisitic and "exalts form over substance" (Br. 19). These are handy tools to replace analysis, but the language seems singularly hollow here. If the leviathan of Internal Revenue is "formalistic," "legalistic," or "unrealistic," it is hardly the fault of the taxpayers. The Commissioner, constantly grasping for alteration of the statutes to the increase of income, must answer for any untoward formalism. Nor are the courts free from criticism when one considers the tenuous reasoning of Putnam v. Commissioner, 352 U.S. 82 (1956), which twisted an ordinary loss into a "bad debt" through application of the legalistic principles of subrogation.

In plain language, taxpayers have suffered an ordinary loss in their trade or business. Congress permits deduction in full of ordinary losses under 26 U.S.C. § 165. Any layman given the hypothetical would immediately recognize the transaction as a trade or business loss, not a bad debt. All should labor diligently to avoid making the law any more unrealistic than it already is. If the law should be changed, Congress is the appropriate body to effect that change.

B. Much Ado About Bad-Debt Losses

Appellant asserts (Br. 20-24) that nonbusiness bad-debt

losses are deductible as capital losses, 26 U.S.C. § 166(d), not as ordinary losses, 26 U.S.C. § 165(c). The statement may be valid but it is irrelevant, since the instant litigation is unconcerned with bad debts, business or nonbusiness in character. See Argument I, supra. Since this case does not fall within the "carved out" (Br. 22) area, appellant's historical analysis is academically interesting but pragmatically unhelpful. The Government concludes that there is "no question that the loss is of a nonbusiness character," and therefore subject to capital-loss treatment (Br. 23-24). This exhortatory statement should be disregarded as wholly unsupported by the record.

C. Taxpayers Suffered Ordinary Losses in a Venture for Profit, and Possessed No Rights of Subrogation Against General. Therefore, Taxpayers are Entitled to an Ordinary Loss Deduction.

The Government relies upon Putnam v. Commissioner, supra, in support of its conclusion that these were "nonbusiness bad-debt" losses. Putnam admittedly is the law. But Putnam was concerned with a guaranty agreement, a secondary obligation, where the taxpayer had a right of subrogation against the primary obligor. While the Government may decry this as undue formalism, it has become legally important, and it is Putnam which is the product of the original formalistic approach.

Taxpayers here suffered an ordinary loss for which the statute allows complete deduction, 26 U.S.C. § 165. If taxpayers paid General pursuant to their obligation as indemnitors and the losses sustained by the plaintiff were incurred as a

result of a profit-seeking activity, then plaintiffs are entitled to ordinary-loss treatment. The district court found the plaintiffs clearly within the ambit of 26 U.S.C. § 165, and that judgment should be affirmed.

The salient inquiry investigates the nature of the plaintiffs' obligation: Were plaintiffs indemnitors of General or guarantors of the corporation? The legal consequences of this inquiry are important. A contract of indemnity is an original undertaking - a primary obligation - as opposed to an agreement to answer for the debt, default or miscarriage of another. In the executed indemnity agreement there exists no "bad debt" comparable to a situation where one party guarantees the obligation of the second. Howell v. Commissioner, 69 F.2d 44 (8th Cir. 1934). See also, in different contexts, Atterbury v. Carpenter, 321 F.2d 921 (9th Cir. 1963) (promissor held to be a surety, not indemnitor); Union Oil Company of California v. Lull, 220 Or. 412, 349 P.2d 243 (1960) (liability of credit card holder to issuer for unauthorized charges); Standard Oil Company of New Jersey v. Commissioner, 7 T.C. 1310 (1946).

Plaintiffs were indemnitors of General. The contract (R. 34-37) established the right of General to proceed directly and primarily against the plaintiffs without first exhausting remedies against the corporation. Plaintiffs retained no rights of subrogation, express or implied, against the corporation. The payments made by plaintiffs by reason of their promise (to hold General harmless from all losses arising by reason of the

bond issued to the corporation) were payments of a direct, primary obligation. As a result, plaintiffs were entitled to an immediate loss-deduction from ordinary income if the payments were qualifed under 26 U.S.C. § 165. Commissioner of Internal Revenue v. Condit, 333 F.2d 585, 586 (10th Cir. 1964); Rietzke v. Commissioner, 40 T.C. 443, 452 (1963); see also Mankoff, Raymond M. "Deduction of Indemnity Losses under §165", 50 A.B.A.J 783 (1964). A loss deduction pursuant to 26 U.S.C. § 165 is permitted if (1) a loss is sustained and (2) the loss was incurred in a transaction entered into for profit.

Taxpayers parted with money and property of a value exceeding their basis ($56,000), but less than the amount of the primary obligation, pursuant to the terms of their agreement with General. This transaction established the losses in the pertinent years.

Taxpayers provided indemnity to General for a valid business purpose. As the result, bonding requirements were met which, it was anticipated, would increase the value of plaintiffs' equity ownership and would pay the plaintiff Lee Hoffman's salary. See Rietzke v. Commissioner, supra; J. J. Shea v. Commissioner, 36 T.C. 577 (1961) /affirmed, per curiam, 327 F.2d 102 (5th Cir. 1954)/; Horner v. Commissioner, 35 T.C. 231 (1960).

The ability of the corporation to conduct business depended upon its bondability. The corporation's ability to furnish bond depended upon the willingness of the taxpayers to

agree to indemnify the compensated surety. If the corporation was unable to conduct its business, it could ill afford to remunerate taxpayer Lee Hoffman for his services rendered as president, and the value of the corporate stock would have been impaired.

Plaintiffs did not select the form of their obligation to General. The indemnity agreement is a form long utilized by compensated sureties. Plaintiffs were required by General to execute the agreement as a condition precedent to the issuance of payment and performance bonds in their business. The reason for General's choice of indemnity agreement (as opposed to a guaranty) is obvious: General desired that the plaintiffs become, in effect, the insurers of General.[7] Any loss incurred by the compensated surety could be collected directly from the plaintiffs-indemnitors without the necessity of proving demand from, or exhaustion of remedies against, the corporation. In order to collect from the indemnitors, General had no duty to even show an obligation from the corporation.

Under these circumstances, satisfaction of plaintiffs' obligation cannot be classified as a bad debt. The legalistic reasoning necessary (via application of subrogation principles) to classify payment by a guarantor as a "bad debt" loss, is simply not applicable to payment made pursuant to a contract

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[7] See "insurance" as one definition of indemnity in the Restatement of Security, cited Br. 26.

of indemnity. Payments under a contract of indemnity, as here, do not take the form of loans, stock purchases, capital contributions, or guarantees of bad debts - as the Government variously attempts to categorize this transaction.

The Government continually resorts to the untenable assumption that plaintiffs somehow "avoided" or "waived" their "worthless right of subrogation." (See e.g., Br. 10, 17). From this posture, the Government claims that plaintiffs were "really" guarantors.

The premise is faulty. Plaintiffs had no right of subrogation against the corporation, express or implied, worthless or valuable. No right of subrogation was reserved in the agreement. Even if an equitable right of subrogation is implied, it would be inappropriately applied here where taxpayers failed to discharge an entire debt. The prohibition against splitting a cause of action is of ancient cognizance; Stark v. Starr, 94 U.S. 477 (1876); Van Norden v. Charles R. McCormick Lumber Co. of Delaware, 27 F.2d 881 (9th Cir. 1928); Henderson v. Morey, 241 Or. 164, 405 P.2d 359 (1965); Wood v. Baker, 217 Or 279, 341 P.2d 134 (1959); plaintiffs' transfer of their fortune and future inheritance fell far short of liquidating the multi-thousand dollar loss. Moreover, taxpayers entered into an agreement of compromise and release with General, obviously destroying any "implied equitable rights of subrogation." Finally, taxpayers transferred all of their personal fortune, including all the stock of the corporation to General; the

Government's waiver theory would necessary posit control of the corporation by taxpayers. Here, the taxpayers were never in the position to control the funds of the corporation.

Assuming, arguendo, that plaintiffs were "guarantors" (or that indemnitors are entitled to subrogation rights despite judicial holdings to the contrary) a payment for a release of taxpayers' liability terminates both the liability and any express or implied right of subrogation. Without a right of subrogation, under the facts posited, there is no "bad debt" deduction pursuant to 26 U.S.C. § 166. Rietzke v. Commissioner, supra; Shea v. Commissioner, supra; Camp Manufacturing Co. v. Commissioner of Internal Revenue, 3 T.C. 467 (1944). The agreement of November 30, 1962 (R. 58-67) wholly releases both plaintiffs and the corporation and terminates any right of subrogation.

The Government's reliance on Putnam v. Commissioner, supra, is unavailing. Putnam is factually inapposite and not controlling. It dealt with a guaranty agreement involving no direct obligation of the taxpayer. The district court's ruling, premised upon such apposite decisions as Howell v. Commissioner, supra; J. J. Shea v. Commissioner, supra; and Rietzke v. Commissioner, supra, is correct and should be affirmed. The assertion that Howell v. Commissioner is somehow distinguishable (Br. 29, 35 seq.) is unappealing; the purported distinctions do not vary the effect of the decision.

The Government, relying upon general textual comments, contends that the existence of the right of subrogation may depend upon the nature of the contract of indemnity (Br. 25, et seq). These comments, taken from the context of a general discussion, are interesting but uninformative.

The right of subrogation either exists or not; no right was specifically reserved in 1958. Even assuming the existence of an implied right to subrogation (contrary to the intent of the parties), such a right would not appertain where a release was executed, since that would be one of the rights remised.

Moreover, the parties did not intend to accord subrogation rights to the plaintiffs who, after the transfer of assets, no longer controlled the subrogee. Thus, the Oregon cases (Br. 32, et seq) concerning liberal attitudes toward subrogation are not germane. Taxpayers possessed no right of subrogation. Even assuming such a right, the compromise transferred that right in return for a full release. Finally, since taxpayers did not discharge the entire obligation (as was done in Putnam), the prohibition against splitting a cause of action would thwart the Government's untenable distinction.

The Government asserts (Br. 33, et seq) that the taxpayers' loss is a nonbusiness bad debt because of the manner in which the parties themselves treated the transaction. Unfortunately, these inferences, based on assumptions outside the record, are faulty.

First, for example, the Government claims that an $11,300 salary item (Br. 34) questioned on another occasion by taxpayer Lee Hoffman in some way permits an inference that the payments by taxpayers to General were contributions to capital or payments pursuant to a guaranty. The facts posited (Br. 34) aliunde the record do not permit the inference or assumption drawn. In truth, prior to the payments by taxpayers under their indemnity agreement to General, taxpayer Lee Hoffman made advances to the corporation. A dispute relating to taxpayers' right to offset these amounts against salary is completely irrelevant to the instant case, as the Government well knows.

Second, the Government relies upon the language in the November 30, 1962 release agreement (Br. 34-35) although the Government itself notes that verbiage does not control substance. The parties agreed that the bank acted as a conduit (R. 32). All payments were made by the taxpayers to General, and not to the corporation or the Bank. (R. 31, 32). The pertinent document is the indemnity agreement executed in 1958.

Third, the Government contends that the April and November, 1961 agreements reflect the type of contract held to be a guaranty in Putnam. (Br. 35-36). This argument is mere wishful thinging. These agreements were executed pursuant to the indemnity agreement of 1958. How could a 1961 document determine the nature and content of the controlling contract executed in 1958? The bargain is for indemnity and no more; Putnam should not be tortured beyond its own internal writhings.

D. Losses Incurred by an Indemnitor Pursuant to an Indemnity Agreement, a Primary Obligation, are Ordinary Losses Deductible Under 26 U.S.C. § 165.

The Government's argument herein (Br. 37-42) does not reflect the law; it is the position of the Government qua advocate, an administrative attempt to alter the existing legislation. The simple answer to Argument I D is leave the issue to Congress.

The Government contends that the district court decision requires examination of state law to determine whether or not a debt exists, since the state law of subrogation controls. The statute and the case law are federal and if the Congress wishes to make an alteration, that body should do so, not the Internal Revenue Service. Of course, Putnam could be read for the broad proposition that bad debt losses do not depend upon the mechanics or particular language used. But the reason for the tortured result in Putnam is the legalistic approach taken by the Internal Revenue Service in an attempt to limit ordinary losses and expand the bad debt category. The brief errs when it assumes, without foundation (Br. 39-40), that there was an infusion of funds into the failing corporation. As explained previously (and see Argument II, infra), this is not the case despite the Government's continual attempt to so label it.

The Government argues that the district court's determination will allow taxpayers, willy-nilly, to alter capi-

tal losses into ordinary losses. This argument, in other forms, has been thoroughly answered elsewhere. Does the Government really believe that the taxpayers forced the agreement of indemnity in 1958 upon General in order to secure a tax break? And did the taxpayers truly expend their entire fortune, including a share of their future inheritance, in order to thwart the revenue laws of the United States?

The first beginning paragraph on page 40 (Br. 40) is unfounded in fact; it is the basic position advocated by the Government. It is not the law and will not be the law until Congress makes the change. It mistakenly assumes that capital contribution was made, in contradiction to all of the agreed and admitted facts.

The argument regarding Congressional intent and legislative history is interesting minutae. The legislative history is ambiguous. Apparently the Government argues that a subsequently-enacted section somehow specified the prior Congressional intent. The cited section has no legal relevance to the cause. If we are interested in history, is not judicial history more salient? Taxpayers respectfully refer to Howell v. Commissioner, supra; J. J. Shea v. Commissioner, supra; and Rietzke v. Commissioner, supra. These decisions, among others, are much more appropriate for this Court's consideration.

II.

Taxpayers Suffered an Ordinary Loss Deductible Under 26 U.S.C. § 165, Not a Capital Loss.

By alternative argument, the Government asserts that the loss suffered by taxpayers should receive capital loss treatment since the sums were allegedly "contributions to capital." (Br. 43-48).

The Government claims that the admitted facts show the corporation was "in dire financial condition and lacked the essential working capital to continue operation." (Br. 43). This conclusion may not be strictly inferable from the admitted facts, but it may be assumed for sake of argument. The Government proceeds from this premise, however, to the faulty conclusion that taxpayers secured for their corporation "contributions of capital" by the infusion of funds from the bank and General and "when the corporation could not repay these sums" the taxpayers suffered a loss (see Br. 43-48 Passim). This characterization misconstrues the admitted facts.

The Government's inability to envision the loan agreements (R. 38-57) as transactions motivated by a quest for profit (Br. 44) is directly related to its studied dismissal of the indemnity agreement (R. 34-37). The loan agreements were not the original agreements of indemnity--they were executed pursuant to the obligations which flowed from the pre-existing indemnity agreement.

If the Government's contention harmonized with reality, taxpayers would have been making capital contributions to a corporation owned and controlled entirely by General, since the stock in the corporation was among the assets they transferred to General. Common sense reveals the absurdity of this contention.

Had plaintiffs been at liberty to chart their own destiny, it is unlikely that they, as rational persons, would have compelled the corporation to complete the outstanding construction contracts at a loss exceeding one-half million dollars. Yet, this is the very course of action chosen, in the Government's view. It was not to the taxpayers' benefit in 1961 and 1962 to make any contribution of capital to their insolvent entity. None of the monies transferred by the plaintiffs to General benefited the corporation. General had bonded the corporation; pursuant to rights under the indemnity agreement, General determined whether or not the contract would be completed at a loss.

A deductible loss, under 26 U.S.C. § 165, requires a finding that the taxpayers' motive in entering the transaction was primarily one of the profit-seeker. The Government recognizes this position (Br. 43-44), but fails to realize that no other motive is deducible from the admitted facts. United States v. Keeler, 308 F.2d 424, 433 (9th Cir. 1962) specifically provides that only the taxpayer's motive or intent is a criteria for determining whether or not a transaction

was one entered into for profit. The admitted facts evoke the conclusion that plaintiffs' motive in executing an agreement of indemnity was solely to enable the corporation to succeed to the plaintiffs' construction business previously operated as a sole proprietorship. Taxpayers intended to enable the business, as continued in a new form, to remain a profitable venture in which taxpayer Lee Hoffman was the sole shareholder, one which paid his salary.

The payments to General in 1961 and 1962 could not be termed an "investment" by any stretch of the imagination. To assert taxpayers were seeking some "loophole" ignores reality and fails to accord with the admitted facts. What taxpayers attempted to do was deduct, for tax purposes, a small portion (an amount equal to their basis) of their entire fortune (including a portion of their future inheritance), which they risked and lost in a transaction entered into for profit. No other motivation is suggested by the Government and none exists.

The Government upon brief has relied upon Keeler, supra, to considerable extent; therefore, the following distinctions are salient:

First, the taxpayer in Keeler executed a contract of guaranty, not an agreement of indemnity.

Second, the Keeler guaranty was given expressly to encourage outside investors to purchase stock in a corporation in which the taxpayer had a substantial interest. Thus, the

guaranty was a direct substitute for investment of capital by the taxpayer. Here, however, plaintiffs' corporation was adequately capitalized and the contract of indemnity was required by the bonding company before it would lend its name as a surety on bonds on public improvements contracts. Keeler is distinguishable from the instant case by reason of the type of third-party obligations secured by the plaintiff's agreement. There was no "investment" secured, directly or indirectly, by entering the indemnity agreement. There was no infusion of equity capital in any form into the corporation.

Third, in Keeler, the loss to which the taxpayer was subrogated was a loss in the value of the capital stock of the corporation; this Court indicated that the taxpayer had no higher rights than those who held the worthless stock. In the case at bench, taxpayers (upon incorporation of their business) agreed to indemnify General for loss in order that their contracting business might continue (as in the past) to bid and perform for public bodies which required payment and performance bonds issued by corporate sureties.

In final analysis, it is unreasonable to assert that plaintiffs gained contributions of capital for their failing enterprise. To have done so would have been the height of folly. Had taxpayers controlled the type of agreement entered, they never would have chosen an indemnity agreement. Instead, taxpayers had no choice of type of agreement; they were bound

to accept the contract tendered by General as a part of its bargain to provide payment and performance bonds. The contract tendered was one long used by compensated sureties. It is inappropriate to confuse the indemnity agreement (R. 34-37) with the agreements entered into years later pursuant to the indemnity agreement (R. 38-57).

III.

The District Court Correctly Denied the Government's Untimely Motion to Amend and Reduce the Judgment.

Judgment was entered on March 21, 1967 (R. 84) after oral argument, submission of voluminous records (see record passim, and briefing by the parties. The Government filed notice of appeal on May 16, 1967 (R. 85), and subsequently moved for an extension of time within which to docket the record (R. 86). Although it does not appear from the documents (R. 87-88), the motion to amend and reduce the judgment was filed and served on July 10, 1967 (R. 147). This is almost four months after the rendition of the judgment. No excuse is available for this administrative lethargy. Footnote 22 (Br. 48-49) ineffectively alibis for the Government. The judgment was entered at least 10 days after the filing of the opinion. The Governeent had been on notice as to the existence, nature, basis and amount of the claim since taxpayers initiated their claims for refund. Let us briefly review the facts:

Taxpayers filed claims for refund (R. 12-18, 19-22) premised upon a net operating loss carry-back. The Internal Revenue Service denied the refund claim and disallowed the deduction except to the extent of $1,000, plus capital gains during the appropriate years, on the sole and exclusive basis that the losses were capital losses (R. 3, 24). Thereafter, taxpayers filed their complaint for refund of taxes (R. 1-22), incorporating the same theory as presented to the Internal Revenue Service. The Government admitted the filing of the return, amended return and refund claims (R. 23), and further admitted that the claims were rejected (except for a portion of the 1961 claim in the sum of $243.99) and that the Internal Revenue Service's sole basis for denial of the claims was that the losses were capital losses (R. 23).

Thereafter, taxpayers moved for summary judgment (R. 25) and a cross-motion for summary judgment was filed by the Government (R. 69). The case was submitted as one on the merits, or stipulated facts. At no time, to this point, was any contention made or raised by the Government that the sum of $9,345.61 was not the proper sum if the losses were deductible. Indeed, this ambush never occurred until July 10, 1967 (R. 87-88).

Moreover, the Government concurred in and accepted the carry-back theory and judicially admitted the validity of the same. For example, in the Government's brief in opposition to the motion for summary judgment and in support of its

own motion for summary judgment (May, 1966), it stated:

> "This is a suit for the recovery of income taxes in the amount of $9,345.61 plus interest paid by the taxpayer for the years 1958 through 1961, inclusive. (The term taxpayer as used herein shall refer to both plaintiffs, Lee and Judy Hoffman).
>
> QUESTION PRESENTED
>
> "Whether payments made by the taxpayer to a bonding company in the year 1962 are deductible as losses from a transaction entered into for profit under Section 165(c)(2), Internal Revenue Code of 1954, or whether such payments constitute either (1) nonbusiness bad debts deductible under Section 166(d)(2), of the Code, or (2) losses from the sale or exchange of capital assets under Section 165(f) of the Code." (R. 100).

In other words, the Government never questioned the accuracy of the amount sought.

Moreover, in the same document (R. 102), the Government stated:

> "STATEMENT
>
> "The Government accepts as true the facts set out in the taxpayers' affidavit in support of his motion."

The district court properly refused to allow the Government's motion to amend the judgment.[8] The motion

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[8] In addition, the Government stipulated to the facts in open Court:

> "THE COURT: I think you would be better off if you would stipulate to all the facts upon which you are basing your motion for summary judgment.
>
> MR. SMITH: I stipulated to them in my brief. I will now stipulate in open Court." (Tr. 37)

The transcript is not a part of the Record.

was not timely filed and served. Plaintiffs were relieved of submitting additional evidence upon the issue of "trade or business" by the judicial admissions of the defendant. The defendant is barred and estopped by the action of its agents to raise the issue of "trade or business" at this late date. Moreover, the district court, and this Court, can determine from the admitted facts that the taxpayer was engaged in the trade or business of rendering managerial and other services to Lee Hoffman, Inc., the corporation, and that the furnishing of the indemnity agreement was done in connection with such a trade or business.

Following submission of the case, briefing, and oral argument, the Court rendered its opinion and order. The judgment was signed on March 21, 1967 (R. 84). The motion to amend was filed and served on July 10, 1967 (R. 147). The filing of the motion was not timely. See, Rules 6(b), 59(e) Fed. R. Civ. P., 28 U.S.C.; Steward v. Atlantic Refining Company, 235 F.2d 570 (3rd Cir. 1956); Gray v. Dukedom Bank, 216 F. 2d 108 (6th Cir. 1954).

Taxpayers were relieved of submitting any evidence on the issue of "trade or business" by virtue of the judicial admissions of the defendant.

Taxpayers moved for summary judgment, attaching by affidavit extensive statements of fact and pertinent exhibits. The Government then submitted a cross-motion for summary judgment and a brief, admitting the facts asserted by the

taxpayers. In its motion, the Government asserted that "there is no genuine issue as to any material fact." (R. 19). In its brief in support of the cross-motion for summary judgment, the Government accepted the proposition that the suit was one for recovery of taxes paid in the amount of $9,345.61, plus interest, and that the sole question was stated to be whether this was a transaction entered into for profit under 26 U.S.C. § 165, or whether it was a nonbusiness bad debt or capital loss.

By the Government's statements to the Court in its cross-motion for summary judgment, and by its comments in its brief in support thereof, the Government has admitted that there exists no issue of law or fact in connection with the concept of "trade or business" raised in the motion to amend. It is to the public good that there be an end to litigation, and a matter once admitted or decided should remain at rest. Each party is entitled to but a single day in court, and successive or untimely reiteration of decided issues is not in the public interest.

The effect of the Government's admission is to relieve the plaintiffs from the need of offering any evidence on the "trade or business" issue. There was no reason to offer such evidence which, of course, was readily available. To have offered the evidence would have been an interjection of collateral and irrelevant matters into the trial, unduly delaying the judicial process. Morey, Admx. v. Redifer et al.,

204 Or. 194, 264 P.2d 418, 282 P.2d 1062 (1955). Blumhorst v. United States Steel Corporation, 238 F.2d 544 (3rd Cir. 1956). See also Meltzer v. Atlantic Research Corporation, 330 F.2d 946 (4th Cir. 1964), and Commissioner of Internal Revenue v. Erie Forge Co., 167 F. 2d 71 (3rd Cir. 1948).

The Government judicially admitted that whether or not the plaintiffs were engaged in a "trade or business" was neither an issue of fact nor one of law in this case. It is now too late to raise the issue; it was too late to raise it in July, 111 days after entry of judgment.

The Government is barred and estopped from taking a contrary position. A suit may not be premised upon omissions induced by the one who sues, Stockstrom v. Commissioner of Internal Revenue, 190 F.2d 283, 288, (D.C. Cir. 1951), and this principle, as well as the doctrines of waiver and estoppel, may be applied to the Commissioner of Internal Revenue. Ibid. The District of Columbia Circuit said, 190 F.2d at 289:

> "It has been well said, that the Government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials."[9]

Estoppel, waiver and unfair inducement principles have often been applied against the Commissioner of Internal

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[9] Disapproved only to the extent that the case holds the Commissioner cannot correct a mistake of law, Automobile Club of Michigan v. Commissioner of Internal Revenue, 353 U.S. 180, 183-184 (1957).

Revenue. See Schuster v. C.I.R., 312 F.2d 311, 317-318 (9th Cir. 1962), where an estate tax return was audited and tax deficiencies paid; a particular trust was not determined includable in the estate. The Commissioner later decided the trust was includable and attempted to assess the bank, which had already distributed the trust assets. See also Exchange and Savings Bank of Berlin v. United States, 226 F. Supp. 56 (D. Md. 1964), estopping the Internal Revenue Service even though the reliance was careless. Confirm, Interstate Fire Insurance Co. v. United States, 215 F. Supp. 586, 599-600 (E.D. Tenn. 1963) /affirmed, per curiam, 339 F.2d 603 (6th Cir. 1964)/; Smale & Robinson, Inc., v. United States, 123 F. Supp. 457 (S.D. Cal. 1954); Walsonavich v. United States, 335 F.2d 96, 101 (3rd Cir. 1964). There is no compelling reason preventing application of the principles of waiver, estoppel, and unfair inducement.

Moreover, the District Court could find from the admitted facts and record that the taxpayer was engaged in the trade or business of rendering managerial and other services to the corporation, and that the furnishing of the indemnity agreement was done in connection with such a trade or business.

Because no issue was ever raised by the Government during either the administrative or the litigation stage, taxpayers' right to carry-back losses under the indemnity agreement with General was assumed by the parties and the

Court was not called upon to decide the issue. However, the Court in deciding the agreed issue, i.e., whether the payments by taxpayers resulted in a bad debt loss or a loss arising from a transaction entered into for profit, held that the transaction was one entered into for profit; in so doing, the Court relied upon the agreed fact that the taxpayer was the salaried president of the corporation and anticipated payments for services if the corporation could successfully conduct its business. The admitted facts indicate that in order to qualify to perform construction work for all public agencies and many private agencies, it was always necessary for the corporation to furnish payment and performance bonds (R. 30). Without taxpayers' agreement to indemnify, General would not furnish the necessary bonds.

Regardless of the definitions of the terms "trade or business" under the Code, it is settled, not only by regulation but also by judicial decision that for the purposes of 26 U.S.C. § 172 (net operating losses), that an employee is engaged in a trade or business and his salary or wage is derived from the operation of that business. 5 Mertons, Law of Federal Income Taxation, § 29.06 p. 71; Swisher v. Commissioner of Internal Revenue, 33 T.C. 506 (1959); Regulations, § 1.172-3(a)(3).

The decisions have been explicit in carrying out the foregoing definition of "trade or business" under 26 U.S.C. § 172 and its predecessor. Folker v. Johnson, 230 F.2d 906

(2nd Cir. 1956); Pierce v. U.S., 254 F.2d 885 (9th Cir. 1958), and cases cited therein. In Folker, supra, the Second Circuit cited with approval the following language of the District Court, 230 F.2d at 909 (n. 5):

> "*** It is true that the business of the corporation was not 'his business'; the separate corporate entity precluded this view even though the taxpayer owned all the issued capital stock, but quite independent of the corporate business, the taxpayer was engaged in trade or business--that of directing and managing the affairs of the corporation. The business of being a corporate officer exists separate and independent of the corporate trade or business. The taxpayer and the corporation, each in law a separate person, each in fact may be engaged in a separate trade or business within the provisions of the tax law. ***."

The Second Circuit concluded, 230 F.2d at 909:

> "Consequently, we hold that the plaintiff, who devoted his entire working time to his duties as a corporate officer, and who received compensation in the form of a salary, was engaged in a trade or business--the trade or business of rendering services for pay. ***."

See also, Harding v. U.S., 113 F. Supp. 461 (Ct. Cl. 1953); Trent v. C.I.R., 291 F.2d 669 (2nd Cir. 1961), and cases cited therein.

The admitted facts show that the corporation was no more than a continuation of the contracting business taxpayer had successfully operated as a sole proprietorship prior to 1958. The "trade or business" of taxpayer changed only to the extent that, during 1958 and prior thereto, he rendered personal services and management to an individual proprietor-

ship and, thereafter, he rendered the same services to the corporation. The corporation would not have been in existence were it not for the taxpayers. By the execution of the indemnity agreement, they made it possible for the corporation to continue in existence.

The most recent case defining "trade or business" is Lundgren v. Commissioner, 376 F.2d 623 (9th Cir. 1967). This Court held that a taxpayer was "in the trade or business of rendering managerial or other services" to his corporation and that the funds advanced to his corporation by the taxpayer therefore bore a proximate relationship to the trade or business which satisfied the requirement of the statute, 376 F.2d at 628. Interestingly, in the Lundgren case, taxpayer as the principal officer of the corporation actually received no salary because he was prevented from doing so by the terms of a Small Business Administration Loan. Lundgren analyzes Whipple v. Commissioner, 373 U.S. 193 (1963) (cited by the Government for a contrary position) and lays to rest such a position.

Thus, had the issue concerning taxpayers' right to carry back the loss been raised timely by the Government, the admitted facts would have justified a finding that taxpayer was engaged in a trade or business--rendering services and managing his corporation--and that the execution of the original indemnity agreement to General was in connection with this trade or business.

CONCLUSION

The judgment of the District Court should be affirmed in all particulars.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Appellees' brief is in full compliance with those rules.

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APPENDIX A

26 U.S.C. § 165

§ 165. Losses

(a) General rule.--There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) Amount of deduction.--For purposes of subsection (a), the basis for determing the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) Limitation on losses of individuals.--In the case of an individual, the deduction under subsection (a) shall be limited to--

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into forprofit, though not connected with a trade or business; and

(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds $100. For purposes of the $100 limitation of the preceding sentence, a husband and wife making a joint return under section 6013 for the taxable year in which the loss is allowed as a deduction shall be treated as one individual. No loss described in this paragraph shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return.

(d) Wagering losses.--Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

(e) Theft losses.--For purposes of subsection (a), any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss.

(f) Capital losses.--Losses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212.

(g) Worthless securities.--

(1) General rule.--If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.

(2) Security defined.--For purposes of this subsection, the term "security" means--

(A) a share of stock in a corporation;

(B) a right to subscribe for, or to receive, a share of stock in a corporation; or

(C) a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form.

* * * * *

26 U.S.C. § 166

§ 166. Bad debts

(a) General rule.--

(1) Wholly worthless debts.--There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

(2) Partially worthless debts.--When satisfied that a debt is recoverable only

in part, the Secretary or his delegate may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(b) Amount of deduction.--For purposes of subsection (a), the basis for determining the amount of the deduction for any bad debt shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) Reserve for bad debts.--In lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary or his delegate) a deduction for a reasonable addition to a reserve for bad debts.

(d) Non business debts.--

(1) General rule.--In the case of a taxpayer other than a corporation--

(A) subsections (a) and (c) shall not apply to any nonbusiness debt; and

(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months.

(2) Nonbusiness debt defined.--For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than--

(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

(e) Worthless securities.--This section shall not apply to a debt which is evidenced by a security as defined in section 165(g) (2) (C).

(f) Guarantor of certain noncorporate obligations.--A payment by the taxpayer (other than a corporation)

in discharge of part or all of his obligation as a guarantor, endorser, or indemnitor of a non-corporate obligation the proceeds of which were used in the trade or business of the borrower shall be treated as a debt becoming worthless within such taxable year for purposes of this section (except that subsection (d) shall not apply), but only if the obligation of the borrower to the person to whom such payment was made was worthless (without regard to such guaranty, endorsement, or indemnity) at the time of such payment.

* * * * *

26 U.S.C. § 172

§ 172. Net operating loss deduction

(a) Deduction allowed.--There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

* * * * *

(c) Net operating loss defined.--For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) Modifications.--The modificiations referred to in this section are as follows:

(1) Net operating loss deduction.--No net operating loss deduction shall be allowed.

(2) Capital gains and losses of taxpayers other than corporations.--In the case of a taxpayer other than a corporation--

(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets; and

(B) the deduction for long-term capital gains provided by section 1202 shall not be allowed.

(3) Deduction for personal exemptions.--No deduction shall be allowed under section 151 (relating to personal exemptions). No deduction in lieu of any such deduction shall be allowed.

(4) Nonbusiness deductions of taxpayers other than corporations.--In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence--

(A) any gain or loss from the sale or other disposition of--

(i) property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

(ii) real property used in the trade or business, shall be treated as attributable to the tradd or business;

(B) the modifications specified in paragraphs (1), (2)(B), and (3) shall be taken into account;

(C) any deduction allowable under section 165(c) (3) (relating to casualty losses) shall not be taken into account; and

(D) any deduction allowed under section 404 or section 405(c) to the extent attri-

butable to contributions which are made on behalf of an individual who is an employee within the meaning of section 401(c) (1) shall not be treated as attributable to the trade or business of such individual.

(5) Special deductions for corporations.--No deduction shall be allowed under section 242 (relating to partially tax-exempt interest) or under section 922 (relating to Western Hemisphere trade corporations).

(6) Computation of deduction for dividends received, etc.--The deductions allowed by sections 243 (relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) (relating to limitation on aggregate amount of deductions); and the deduction allowed by section 247 (relating to dividends paid on certain preferred stock of public utilities) shall be computed without regard to subsection (a) (1) (B) of such section.

* * * * *

U.S. Code Cong. and Admin. News, Federal Tax Regulations, 1961, § 1.172-3 (a) (3):

(3) Nonbusiness deductions--(i) Ordinary deductions. Ordinary nonbusiness deductions shall be taken into account without regard to the amount of business deductions and shall be allowed in full to the extent, but not in excess, of that amount which is the sum of the ordinary nonbusiness gross income and the excess of nonbusiness capital gains over nonbusiness capital losses. See paragraph (c) of this section. For purposes of section 172, nonbusiness deductions and income are those deductions and that income which are not attributable to, or derived from, a taxpayer's trade or business. Wages and salary constitute income attributable to the taxpayer's trade or business for such purposes.

(ii) Sale of business property. Any gain or loss on the sale or other disposition of property

which is used in the taxpayer's trade or business and which is of a character that is subject to the allowance for depreciation provided in section 167, or of real property used in the taxpayer's trade or business, shall be considered, for purposes of section 172(d) (4), as attributable to, or derived from, the taxpayer's trade or business. Such gains and losses are to be taken into account fully in computing a net operating loss without regard to the limitation on nonbusiness deductions. Thus, a farmer who sells at a loss land used in the business of farming may, in computing a net operating loss, include in full the deduction otherwise allowable with respect to such loss, without regard to the amount of his nonbusiness income and without regard to whether he is engaged in the trade or business of selling farms. Similarly, an individual who sells at a loss machinery which is used in his trade or business and which is of a character that is subject to the allowance for depreciation may, in computing the net operating loss, include in full the deduction otherwise allowable with respect to such loss.

(iii) Casualty losses. Any deduction allowable under section 165(c) (3) for losses of property not connected with a trade or business shall not be considered, for purposes of section 172(d) (4), to be a nonbusiness deduction but shall be treated as a deduction attributable to the taxpayer's trade or business.

(iv) Limitation. The provisions of this subparagraph shall not be construed to permit the deduction of items disallowed by subparagraph (1) of this paragraph.

CERTIFICATION OF SERVICE

I, RIDGWAY K. FOLEY, JR., attorney for Appellees, hereby certify that I served by mail three true and correct copies of the Appellees' Brief on counsel for the Commissioner of Internal Revenue on the 22 day of January, 1968. I further certify that the copies were placed in a sealed envelope addressed to Mitchell Rogovin, Assistant Attorney General, Department of Justice, Washington, D.C. 20530; said sealed envelope was then deposited in the United States Post Office at Portland, Oregon on the day last mentioned with the postage thereon fully paid.

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No. 22096

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HENRIETTA M. FAUCHER, also known as H. M. FAUCHER,

Appellant,

vs.

DOLORES KNOLL LOPEZ, LOUISE M. GIOVANNONI, and JOSEPH E. HAZEL,

Appellees.

APPELLANT'S OPENING BRIEF.

FILED

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No. 22096

IN THE

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HENRIETTA M. FAUCHER, also known as H. M. FAUCHER,

Appellant,

vs.

DOLORES KNOLL LOPEZ, LOUISE M. GIOVANNONI, and JOSEPH E. HAZEL,

Appellees.

APPELLANT'S OPENING BRIEF.

Introductory Statement.

This is an appeal by Henrietta M. Faucher, also known as H. M. Faucher, from a judgment entered by the District Court sitting with a jury after a directed verdict in favor of Appellees adjudicating Apellant a bankrupt [R. 396, 397, 398 and 399][1] and from the findings and report of the Special Master and the affirmation thereof by the Court.

The cause was brought to bar by Appellees' filing of an Involuntary Petition in Bankruptcy against Appellant [R. 65]. The District Court, pursuant to Rule

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[1]References to the Clerk's record of proceedings are denoted "R."

References to the trial before the Special Master are denoted "S.M. Tr."

References to the trial before the District Court are denoted "D.C. Tr."

53 (e) (2) of the Bankruptcy Act appointed Joseph J. Rifkind Special Master as a part of its Pretrial Conference Order of April 7, 1966, and thereafter, a trial was held before the Honorable Joseph J. Rifkind, as Special Master, without a jury, in connection with the non-jury issues as set forth in the said Pretrial Conference Order. The Report of the Special Master was filed on August 12, 1966 [R. 350], and over the objection of Appellant, the Report of the Special Master was affirmed by the District Court by order filed February 9, 1967, which order was modified by order of the District Court filed May 3, 1967 [R. 367]. That thereafter, a trial was held before the District Court sitting with a jury, in connection with the remaining jury issues and after completition of testimony, the District Court, upon motion of Appellees granted a directed verdict, discharged the jury and issued its findings of fact, conclusions of law and judgment [R. 396, 397, 398 and 399]. Appellant made a motion for new trial [R. 369] which motion was denied and thereafter filed her Notice of Appeal [R. 400].

Statement of Jurisdiction.

The statutory jurisdiction of this cause in the District Court, exists pursuant to the Bankruptcy Act, United States Code, Title 11, Section 95 (b).

The jurisdiction in the United States Court of Appeals is conferred by the United States Code, Title 28, Section 1294.

Statement of the Case.

On May 13, 1963, Appellees herein filed a Creditors Petition in Involuntary Bankruptcy against Appellant whch alleged, in substance, that Appellant within four months next preceding the filing of the Petition committed acts of bankruptcy in that she suffered and permitted, while insolvent, a Writ of Attachment to be issued against her on March 13, 1963, which lien was not vacated or discharged within 30 days from the date of its creation and in addition, that the Appellant did suffer or permit on or about March 22, 1963, the appointment of a Receiver to take charge of certain of her property at a time when she was insolvent. That Appellees therefore prayed that Appellant be adjudged by the Court to be a bankrupt [R. 65-69].

That thereafter, on August 21, 1963, Appellant herein filed her Answer to the Involuntary Petition in Bankruptcy [R. 71-73], which Answer substantially denied the moving allegations of the Petition in Bankruptcy and further alleged, by way of separate affirmative defense, that the monies alleged to have been delivered by Appellees constituted loans and as such were usurious in nature, in that the monies repaid or agreed to be repaid to Appellees and each of them, exacted or sought to exact interest and bonus or discount in excess of the legal rate of interest under and pursuant to the laws of the State of California. Said Answer further alleged that as a result of the acts of Appellees in either obtaining or seeking to obtain usurious interest under California law, that Appellees were before the Bankruptcy Court as a Court of Equity, with unclean hands and should therefore be precluded from obtaining equitable relief therefrom [R. 71-74]. Thereafter,

Appellant filed her demand for a jury trial on August 21, 1963 [R. 75].

The following issues of fact and questions involved were before the Court and submitted to the Special Master for trial without a jury:

I. Whether the claims asserted by Appellees are debts of Appellant.

II. Whether said claims, if any, are secured or unsecured.

III. Whether Appellant owed debts in excess of $1,000.00.

IV. Whether Appellees have unclean hands and are therefore barred from proceeding with their Involuntary Petition in Bankruptcy.

V. Whether the Appellant is estopped to claim that Appellees had unclean hands.

VI. Whether under the circumstances of the present cause the burden of proof on the issue of insolvency shifts from Appellees to Appellant.

VII. Whether the transactions which are the basis of the Involuntary Petition in Bankruptcy, are usurious.

The following issues of law were also referred to the Special Master:

I. Whether the insolvency of Appellant may be inferred from evidence that certain obligations of the Appellant were not paid when due at the time of or an instant before the alleged act of bankruptcy occurred.

II. Whether the insolvency of Appellant may be inferred from evidence that certain obligations

of the Appellant were not paid when due subsequent to the time when the acts of bankruptcy allegedly occurred.

The further questions and issues involved which were reserved for trial before a jury were as follows:

I. Whether at the time of the levy of attachment on March 13, 1963, or at the date of the appointment of the State Court Receiver on March 22, 1963, Appellant was insolvent under either of the following tests:

(a) The total of her liabilities exceeded the total aggregate of her assets taken at their fair value; or

(b) She was unable to pay her debts as they matured. (Pretrial Conference Order, April, 7, 1966).

Specification of Errors.

I.

Appellant was prevented from having a fair trial because of the irregularities in the proceedings of the Court.

(a) The reference of the non-jury aspects of the cause to a Special Master was improper.

(b) The failure of the Court to arrange for the presence of Appellant at the trial of the matter, both before the Special Master and before the District Court, over the objections of counsel, during a time when she was incarcerated in the Womens State Prison at Frontera, California, under the jurisdiction of the State of California, constituted a denial of due process under the Fifth Amendment of the United States Constitution [S.M. Tr. p. 4, line 7, to p. 14, line 2; D.C. Tr. p. 39, line 6, to p. 47, line 14].

II.

The evidence adduced at both the first trial before the Special Master and the second trial before the District Court is insufficient to justify the order of adjudication.

(a) Appellees failed to introduce a prima facie case as to the insolvency of Appellant on March 13, 1963, or March 22, 1963, and failed to show that Appellant was unable to pay her debts as they became due on said dates, [D.C. Tr. p. 131, lines 7-25, D.C. Tr. p. 110, line 15, to p. 112, line 10, D.C. Tr. p. 145, line 6, to p. 153, line 11, D.C. Tr. p. 61, line 14, to p. 64, line 15].

(b) The report and findings of the Special Master [R. 350] were based upon insufficient evidence and were objected to by Appellant [R. 361-363]. The said findings of the Special Master, which were objected to, are as follows:

1. The claims asserted by JOSEPH E. HAZEL, REBECCA M. HAZEL, JOHN J. GIOVANNONI, LOUISE M. GIOVANNONI and DOLORES KNOLL LOPEZ are debts of the Alleged Bankrupt, HENRIETTA M. FAUCHER.

2. That such obligations are unsecured debts of the Alleged Bankrupt which were in existence at the time of the filing of the Involuntary Petition herein.

3. That the Alleged Bankrupt, at the time of the filing of the Involuntary Petition against her, owed debts in excess of $1,000.00.

4. That the Petitioning Creditors do not have unclean hands and are therefore not barred

from proceeding with the Involuntary Petition proceeding instituted by them.

5. That the Alleged Bankrupt is estopped to claim that the Petitioning Creditors have unclean hands.

6. That under the circumstances of the case, the burden of proof of insolvency has shifted from Petitioning Creditors to the Alleged Bankrupt and that she has failed to assume or sustain such burden.

7. The transaction's which are the basis for Petitioning Creditors claims are not usurious.

(c) Over the objections of Appellant, the findings and report of the Special Master were affirmed by the District Court (Order Dated February 9, 1967).

(1) Finding 1 of the Special Master is claimed to be erroneous in that there was a total lack of evidence that the notes and deeds of trust were executed by Appellant. [R. 357; S.M. Tr. p. 19, lines 20-23; p. 28, lines 18-26; p. 20, lines 9-13; p. 141, lines 15-20; p. 223, lines 16-26; p. 229, line 20, to p. 230, line 2; p. 101, lines 15-22; p. 106, lines 6-16].

(2) Finding 2 is claimed to be error in that there was no evidence adduced that the obligations in question were or are debts of Appellant [R. 358; S.M. Tr. p. 435, line 10, to p. 436, line 11].

(3) Finding 4 is claimed to be error in that the evidence reflects that Appellees herein appeared before the Court below with unclean hands, in that there was ample evidence from the

face of the notes and deeds of trust that the Appellees bargained for usurious interest and discount and should therefore have been barred from proceeding with the Involuntary Petition in Bankruptcy before a Court of Equity. [R. 358; S.M. Tr. p. 44, line 1, to p. 47, line 2; p. 49, line 17, to p. 59, line 26; p. 21, lines 20-26; p. 27, line 20, to p. 28, line 11; p. 86, lines 1-7; p. 88, lines 1-4; p. 90, lines 5-7].

(4) Finding 5 of the Special Master is claimed to be error on the basis that as a matter of law, Appellant may not be estopped from claiming as a matter of defense, the unclean hands of Appellees where Appellees knowingly and intentionally entered into usurious transactions and admittedly would not have entered into said transactions had the amount of interest and discount not been in excess of the legal rate of interest under California law [R. 358; S.M. Tr. p. 86, lines 1-7; p. 88, lines 1-4; p. 90, lines 5-7; p. 142, line 23, to p. 144, line 8; p. 269, lines 13-21].

(5) Finding 6 was objected to as error on the grounds that the burden of proof on the issue of the insolvency of Appellant should have rested with Appellees and that the burden of proof should not have shifted to Appellant in that Appellant had never failed or refused to turn over her books and records, but in fact was never ordered to do so by the District Court [R. 358].

(6) Finding 7 of the Special Master is claimed to be error on the basis that the evidence sustains a finding that each of the transactions were in fact usurious [R. 358].

III.

Substantial errors in law occurred at the trial of this matter before the District Court, as follows:

(a) That the District Court, on May 3, 1967 [R. 367-368], ordered that the burden of proof on the issue of insolvency or the inability of the Appellant to pay her debts as they matured, shifted from Appellees to the Appellant, unless the Appellant appeared in Court at the trial of said issue with her books, papers and records and submitted to examination and gave testimony as to all matters tending to establish her solvency or insolvency. That said order was made at a time when the Appellant was under a civil disability and the Court was aware thereof, in that the Appellant was incarcerated in the California Prison for Women at Frontera, California, and was not present at the trial of the matter, due to the inability of the United States Marshal to obtain her presence and deliver her for the trial of this matter, despite the issuance of a Writ of Habeas Corpus Ad Testificandum by the Court [D.C. Tr. p. 39, line 6, to p. 46, line 16].

(b) Further claim of error of law was the Court's granting of Appellees' motion for a directed verdict thereby removing the decision from the jury who had heard the evidence [R. 398, D.C. Tr. p. 177, lines 4-6].

ARGUMENT.

I.

The Conduct of Appellees Is in Violation of the California Usury Laws and as Such, Appellees Have Sought the Aid of the Bankruptcy Court as a Court of Equity, Despite the Fact That Their Conduct Has Tainted Them With Unclean Hands.

It is submitted that the evidence adduced at the trial before the Special Master clearly indicates that Appellees herein voluntarily entered into a series of transactions in which they either sought to or did obtain interest in excess of that permitted under the usury laws of the State of California and that therefore, Appellees may not be permitted to seek relief from the Bankruptcy Court utilizing its equitable jurisdiction, when their violation of the California law relating to usurious interest taints them with unclean hands.

It is submitted that the following evidence adduced at the hearing before the Special Master is uncontroverted:

(a) Dolores Knoll Lopez, one of the Appellees herein, testified that on or about the month of November, 1960, she loaned the sum of $5,000.00 in consideration for which he received a Promissory Note in the face amount of $5,555.56, plus interest on said sum as appears on the face of the note [S.M. Tr. p. 21, line 20, to p. 22, line 3; Ex. 2]. This discount or bonus from the face of the note when coupled with the amount of interest apparent from the face of the note constitutes interest in excess of 10%, the amount permitted under California law. The situation is substantially the same

in connection with the testimony of Mrs. Lopez concerning the month of August, 1962, at which time she loaned the sum of $2,500.00 in consideration for which she received a Promissory Note in the face amount of $2,631.50 [Ex. 6; S.M. Tr. p. 27, line 20, to p. 28, line 11]. Mrs. Lopez testified that she considered the difference between what she loaned and the face amounts of the notes to be a bonus [S.M. Tr. p. 86, lines 1-7; p. 88, lines 1-4; p. 90, lines 5-7].

(b) In the case of Louise M. Giovannoni, the evidence is also clear that on or about the month of April, 1957, Mr. and Mrs. Giovannoni loaned the sum of $6,750.00, in consideration for which they received a series of three Promissory Notes each in the face amount of $2,500.00, for a total of $7,500.00. That although the interest provided to be paid on each note was below the maximum permitted under California law, when said interest is coupled with the amount of discount or bonus evidenced from the face of said notes, when compared to the amount of cash actually loaned, it is in excess of the legal rate of interest permitted under California law [Exs. 8, 9 and 10; S.M. Tr. p. 142, line 3, to p. 144, line 8].

(c) In addition, Mr. and Mrs. Giovannoni, on or about the month of December, 1960, loaned the sum of approximately $10,000.00 or less in consideration for which they received two Promissory Notes each in the face amount of $5,555.55, bearing interest on the face thereof at 7.2% per annum, for a total face amount of said notes in the sum of $11,111.10 [Ex. 14; S.M. Tr. p. 117, line 4, to

p. 118, line 14; p. 144, lines 6-8; p. 167, lines 16-18; p. 168, lines 17-25; p. 169, lines 6-14].

(d) On or about the month of March, 1962, Mrs. Giovannoni again loaned the sum of $10,000.00 in consideration for which she received a Promissory Note in the face amount of $11,110.00, and again when the said discount is added to the interest apparent from the face of the note, it is in excess of the rate of interest provided under California Law [Ex. 16; S.M. Tr. p. 176, lines 14-25; p. 192, line 2, to p. 198, line 14].

(e) The evidence is similarly clear in connection with Joseph E. Hazel. On or about the month of July, 1958, Mr. Hazel and Rebecca M. Hazel loaned the sum of $4,050.00 in consideration for which they received a Promissory Note in the face amount of $4,500.00, which note bore interest at the face amount of 7.2% per annum. Again the Promissory Note appears fair on its face, but when the interest is coupled with the bonus or discount, it provides for interest substantially in excess of that permitted under California law [Ex. 17; S.M. Tr. p. 224, lines 1-4].

(f) On or about the month of January, 1961, Joseph E. Hazel and Rebecca M. Hazel loaned the sum of $6,000.00 in consideration for which they received two Promissory Notes each in the face amount of $3,333.33, for a total of $6,666.66, plus interest thereon at the rate of 7.2% per annum [Ex. 19; S.M. Tr., p. 229, lines 1-6].

It must be noted that Mr. Hazel further testified, without contradiction, that but for the bonus or discount he received on the face of each note, he would

not have entered into the loan transactions [S.M. Tr. p. 269, lines 13-22].

It is thus submitted that Appellees have sought to extract and actually received usurious interest and have therefore, sought the aid of a Court of Equity with unclean hands.

In the case of *Teichner v. Klassman* (1966), 240 Cal. App. 2d 514, 49 Cal. Rptr. 742, the Court found that the loan agreements whereby Plaintiff loaned Defendant sums of money were usurious loan transactions. The Court also found that an *estoppel* does not arise simply because the borrower (in the present cause purported to be Appellant) knew of the usurious nature of the transaction, took the initiative in seeking the loan, and paid usurious interest without protest.

California law is clear that a transaction in order to be usurious does not have to be usurious on its face.

Haines v. Commercial Mortgage Co. (1927), 200 Cal. 609, 254 Pac. 956.

The conscious and voluntary taking of more than the legal rate of interest constitutes usury and the only intent necessary on the part of the lender is to take the amount of interest which he receives and if that amount is more than the law allows, the offense is complete.

Thomas v. Hunt Mfg. Corp. (1954), 42 Cal. 2d 734, 269 P. 2d 12;

Kleet v. Security Acceptance Co. (1952), 38 Cal. 2d 770, 242 P. 2d 873;

Shirley v. Britt (1957), 152 Cal. App. 2d 666, 313 P. 2d 875;

Janisse v. Winston Investment Co. (1954), 154 Cal. App. 2d 580, 317 P. 2d 48;

Williams v. Reed (1957), 48 Cal. 2d 57, 307 P. 2d 353.

It should also be noted that a person, though not a party to a transaction, may attack the transaction as usurious if he is injured by it.

Roesch v. DeMota (1944), 24 Cal. 2d 562, 150 P. 2d 422.

It is true that the question of usury is not raised for the purpose of defeating Appellees as creditors, but merely to disqualify them from acting as Petitioning Creditors in an involuntary bankruptcy proceeding on the basis that their conduct is tainted with unclean hands and that therefore, they may not be aided by a Court of Equity as a result of this conduct in violation of the usury laws of the State of California.

The policy of the State of California, as concerns the question of usury limiting interest to 10%, is included directly in the State Constitution Article XX, Section 22. It is worthy of note that usury in certain instances has been made a misdeameanor and therefore, a criminal violation under California law.

Derring's General Law, Act 3757, Section 3.

Where a lender receives a Promissory Note for a greater amount than the principal amount of the loan which he actually makes, this constitutes usury.

Henning v. Akin (1928), 91 Cal. App. 246, 266 Pac. 981;

Richlin v. Schleimer (1932), 120 Cal. App. 40, 7 P. 2d 711;

Courtney v. Tufeld (1932), 128 Cal. App. 504, 17 P. 2d 1035;

Anderson v. Lee (1951), 103 Cal. App. 2d 24, 228 P. 2d 613.

A "bonus or discount" is treated as interest in determining the existence of usury.

Williams v. Reed (1957), 48 Cal. 2d 57, 307 P. 2d 353.

When a transaction violates the usury law, the intent of the parties is immaterial, nor is it material that the borrower rather than the lender took the initiative in the transaction.

Martin v. Kuchler (1931), 212 Cal. 536, 299 Pac. 52;

Martin v. Ajax Construction Co. (1954), 124 Cal. App. 2d 425, 269 P. 2d 132;

Williams v. Reed, supra.

It is submitted that bankruptcy actions are equitable in nature and are therefore, controlled by equitable principles.

Cowan's Bankruptcy Law, Section 1075, page 627;

In Re Christensen (1900), 101 Fed. 243;

Precision Instrument Mfg. Co. v. Automotive M. M. Co. (1945), 324 U.S. 306, 65 S. Ct. 993.

Where a party has been guilty of improper conduct which violates the basic rules of equity jurisprudence, equity must deny him any recognition or relief.

DeGarmo v. Goldman (1942), 19 Cal. 2d 755, 123 P. 2d 1;

Crittenden v. McCleod (1951), 106 Cal. App. 2d 42, 234 P. 2d 642;

Katz v. Karlsson (1948), 84 Cal. App. 2d 469, 191 P. 2d 541.

In *DeGarmo v. Goldman, supra,* the Court stated, in substance, that it is not only the fraud or the commission of an illegal act that will prevent the Plaintiff from gaining admission into the Court, but any unconscientious conduct on his part, related to the controversy at hand will keep him out.

In *Katz v. Karlsson, supra,* the Court stated, in substance, that a Plaintiff's improper conduct need not be of a criminal character or even of a nature sufficient to constitute the basis of a cause of action against him. His hands are rendered unclean within the purview of the maxim by any form of conduct that, in the eyes of honest and fairminded men may properly be condemned, and pronounced wrongful.

It is submitted that the participation in usurious transactions by Appellees herein, taints them with unclean hands and therefore, equitable relief of any kind should have been denied to them, and the Court below should have refused to lend its aid and dismissed the petition.

30 *Corpus Juris Secundum,* Equity, Section 93;

Gavina v. Smith (1944), 25 Cal. 2d 501, 154 P. 2d 681.

Even though the Trial Court may have felt that Appellant's conduct was wrongful, the relief prayed for

by Appellees should have been denied, under the doctrine of unclean hands.

Precision Instrument Mfg. Co., v. Automotive M. M. Co., supra;

In Re Christensen, supra.

It is often stated that the theory and principal purpose of the unclean hands doctrine is to preserve and protect the integrity of the Court.

Katz v. Karlsson, supra;

Gaudiosi v. Mellon (CCA 3rd 1959), 269 F. 2d 873, Cert. Denied 361 U.S. 903.

The doctrine of unclean hands is applicable to bankruptcy proceedings.

8 *Corpus Juris Secundum,* Bankruptcy, Section 22;

Bolling v. Bowen (CCA 4th 1941), 118 F. 2d 59.

In the case of *Precision Instrument Mfg. Co. v. Automotive M. M. Co., supra,* the Court held that the doors of the Court of Equity would be closed to one tainted with bad faith, however improper may have been the behavior of the Defendant. This doctiine is rooted in the historical concept of the Court of Equity as the vehicle for affirmatively enforcing the requirements of conscience and good faith.

It is submitted that the uncontroverted testimony of Appellees herein clearly reflects that they sought to and did obtain payment of interest and bonus or discount in excess of the rate provided under California law and that therefore, they sought to extract usurious interest thereby tainting them with unclean hands before a Court of Equity. It is further apparent that

there was a total lack of evidence at the trial of this cause that the Promissory Notes and Deeds of Trust in question were in fact signed by Appellant herein or that the said documents bore the name of Appellant, nor was there documentary evidence submitted that any of the loan obligations claimed by Appellees were in fact debts or obligations of Appellant, or that Appellant, in fact, owed any financial obligation to Appellees. Specific references to the transcripts in connection with these matters has heretofore been set forth within the Specification of Errors.

II.

The Exclusion of Appellant From the Trial of This Cause Violated the Due Process Protection Guaranteed to Her Under the Constitution of the United States.

It is submitted that the proceedings herein, both before the Special Master and before the District Court violated the Constitutional rights of Appellant under and pursuant to the Fifth Amendment of the United States Constitution, in that Appellant has been denied Due Process of Law.

Pursuant to order of the District Court, counsel for Appellant prepared a Writ of Habeas Corpus Ad Testificandum and an order thereon which was executed by the Judge of the District Court, directing George E. O'Brien, United States Marshal for the Southern District of California, to bring and deliver Appellant to the Courtroom of the Honorable Joseph J. Rifkind, Referee in Bankruptcy, serving herein as Special Master, for the purpose of being in attendance at the trial of the matter. In violation of the said order for Writ of Habeas Corpus Ad Testificandum, Appellant was not

delivered to the proceedings before the Special Master from the California Institution for Women and was, therefore, deprived of her right to be present at the trial of the cause before the Special Master. Over the objection of counsel for Appellant, the Special Master proceeded with the trial of the matter despite the absence of Appellant by virtue of the failure of the United States Marshal to deliver her to the Federal Court for the purpose of being present at the proceeding [S.M. Tr. p. 4, line 7, to p. 14, line 1; R. 352, line 7, to p. 354, line 21].

A similar set of facts existed in connection with the jury trial portion of the cause before the District Court. At that time the Court ordered the issuance of a Writ of Habeas Corpus Ad Testificandum again to George E. O'Brien, United States Marshal, and the California Institution for Women, at Frontera, California, ordering and directing Appellant to be brought to the Courtroom on May 3, 1967, for the jury trial. In connection therewith, costs were paid through counsel for Appellant, however, Appellant was not delivered to the Courtroom by the United States Marshal and appeared at no stage of the proceeding nor was she permitted to appear at any trial stage of the proceeding [R. 366; D.C. Tr. p. 39, line 6, to p. 46, line 3].

Excluding a Defendant from participation in a trial for failure to pay suit money and alimony was held a denial of due process.

Hutchinson v. Hutchinson, 126 Ore. 519, 270 Pac. 484, 62 A.L.R. 660;

Collins v. Superior Court (1956), 145 Cal. App. 2d 588, 302 P. 2d 805;

Hayman v. Morris, 37 N.Y.S. 2d 84.

A Defendant must have an opportunity to be heard in his own defense.

Beck v. Occidental Life Ins. Co. (C.C.A. 10th, 1938), 95 F. 2d 935, Cert. denied 59 S. Ct. 305, 63 U.S. 603;

Hicklin v. Edwards (C.C.A. Mo. 1955), 226 F. 2d 410.

An essential element of due process of law is a hearing or an opportunity to be heard on the merits of a cause. This is a matter of right and this element of due process includes the right of the party to be present during the taking of testimony or evidence and to hear the evidence introduced against him.

Remington Athletic Commission v. Bratton, 117 Pa., *supra,* 598, 112 A. 2d 422.

In the *Remington Athletic Commission v. Bratton,* case, the Court states:

> "There is no hearing when the affected party has not the means of knowing what evidence is offered or considered and is not afforded an opportunity to test, explain or refute it."

It is thus submitted that the exclusion of Appellant from participation in both segments of the trial of this cause was improper and constitutes a denial of due process of law.

Arrington v. Robertson (C.C.A. 3rd 1940), 114 F. 2d 821;

Ah Fook Chang v. United States (C.C.A. 9th 1937), 91 F. 2d 805.

It is respectfully suggested that the failure of the United States Marshal to have the Appellant present

for the trials and the failure of the District Court to properly enforce its order for issuance of Writ of Habeas Corpus Ad Testificandum prevented Appellant from confronting the witnesses against her, from knowing what evidence was offered against her and from having an opportunity to explain or refute the evidence if such was her desire, and thereby effectively deprived Appellant of her assets, estate and property in the nature of a forfeiture, without a real opportunity to present testimony on her own behalf, all of which constitutes a violation of her constitutional rights of due process under the Fifth Amendment of the Constitution of the United States.

III.

The District Court Erred in Shifting the Burden of Proof on the Question of Insolvency From Appellees to Appellant.

The Bankruptcy Act, Title 11, Section 21, provides that in connection with the two acts of bankruptcy alleged by Appellees, that the acts must have occurred at a time when the Appellant was insolvent. In this connection, petitioning creditors are normally obligated to prove the insolvency of the alleged bankrupt at the time of the commission of the alleged act or acts of bankruptcy.

> *In re Rome Planing Mill* (1899), 96 Fed. 812;
> *National Refining Company v. Pennsylvania Petroleum Company* (C.C.A. 8th 1933), 66 F. 2d 914, Cert. Den. 291 U.S. 667.

It is true that the burden of proof on the question of insolvency may shift from petitioning creditors to the alleged bankrupt under certain circumstances, one of

which is the refusal of the alleged bankrupt to appear with her books and records. It is also true in the event the alleged bankrupt has a satisfactory explanation for not presenting books and records, that the burden of proof does not shift and the petitioning creditors maintain the burden of proving the insolvency.

Cummins Grocer Co. v. Talley (C.C.A. 6th 1911), 187 Fed. 507.

The District Court, in its order of May 3, 1967 [R. 367], amended Finding 6 of the Special Master as follows:

> "The burden of proof on the issue of insolvency of the Alleged Bankrupt or the inability of the Alleged Bankrupt to pay her debts as they mature will shift from Petitioning Creditors to the Alleged Bankrupt at the trial of that issue unless the Alleged Bankrupt appears in Court at the trial of said issue with her books, papers and accounts and submits to an examination and gives testimony as to all matters tending to establish insolvency or solvency and the ability or inability of the Alleged Bankrupt to pay her debts as they mature, as provided in Section 3 (b) of the Bankruptcy Act (11 U.S.C. Section 21)."

The file in the present cause will reflect that at no time prior to the said order of May 3, 1967, was Appellant ordered or instructed to appear and produce her books and records but in fact, a prior motion of Appellees for a turn-over order of books, records and documents was denied by the Presiding Judge of the District Court [R. 226, 230-231].

It is submitted that Appellant's exercise of her constitutional privilege against self-incrimination is in itself a satisfactory explanation for not turning over books, records and documents and that the burden of proof should therefore not have shifted to Appellant, but should have been carried in the usual manner by Appellees.

The fact that the Court in its Order of May 3, 1967 [R. 367-368], ordered the shifting of the burden of proof from Appellees to Appellant at a time when the District Court was aware that its order for Writ of Habeas Corpus Ad Testificandum had not been effected by the United States Marshal and that therefore, the Appellant could not possibly appear at the trial of the matter and could not produce books, records, papers and documents seems to be ample evidence that the burden of proof was shifted from Appellees to Appellant without due process of law and without consideration of the fact that such appearance and presentation could not be made.

If an alleged bankrupt has been lawfully deprived of her books and records, the burden of proof on the question of insolvency does not shift but remains with the petitioning creditors.

> *In re Ross and O'Brien Iron Works, Inc.* (CCA 2d 1932), 58 F. 2d 961.

It is suggested in the present cause that Appellant had in fact been deprived of her books and records in that she was incarcerated in the California Institution for Women as a result of which she was not able to appear for the trial of this matter, nor was she, while incarcerated, in possession of any books, records or

documents and that Appellant therefore had been substantially deprived, as a result of her incarceration, of said books, records and documents and was not physically able to produce the same.

That as a result of the District Court's Order of May 3, 1967 [R. 367-368], Appellees were not required to establish the usual burden of proof on the insolvency of Appellant and were therefore able to obtain Appellant's adjudication as a bankrupt without proving the necessary elements of the acts of bankruptcy alleged, namely Appellant's insolvency at the time of the levy of the Writ of Attachment and/or at the time of the appointment of the California State Court Receiver.

IV.

The District Court Improperly Directed a Verdict in Favor of Appellees.

The District Court, after three partial days of jury trial, upon motion of Appellees, directed a verdict of adjudication of bankruptcy against Appellant [D.C. Tr. p. 177, lines 4-6; R. 396-398].

The District Court, in its Findings of Fact [R. 397], stated as follows:

> "The Petitioning Creditors presented evidence which was sufficient to establish a prima facie case that the Alleged Bankrupt was unable to pay her debts as they mature on the date of the acts of bankruptcy alleged. The Alleged Bankrupt produced evidence in defense of the charge of the Petitioning Creditors and rested. The Petitioning Creditors moved for a directed verdict. The fact that the Alleged Bankrupt was unable to pay her

debts as they mature on the dates of the acts of bankruptcy alleged by Petitioning Creditors was supported by the overwhelming weight of the evidence and the inferences to be drawn therefrom. Reasonable men could not possibly come to a different conclusion. Accordingly, the Court granted the motion of the Petitioning Creditors and directed a verdict that the Alleged Bankrupt was unable to pay her debts as they mature on the dates of the acts of bankruptcy alleged and based upon said verdict, the Court so finds."

A motion for a directed verdict may properly be granted only when a jury verdict in the other party's favor would have to be set aside by the Court.

Standard Accident Ins. Co. v. Winget (9th Cir. 1952), 197 F. 2d 97;

Wong v. Swier (9th Cir. 1959), 267 F. 2d 749;

Hawley v. Alaska S.S. Co. (9th Cir. 1956), 236 F. 2d 307.

In deciding whether to direct a verdict under Rule 50 of the Rules of Civil Procedure, the Court must determine whether the evidence, in its entirety would rationally support a verdict for the party opposing the motion assuming that the jury took a view of the evidence most favorable to the opposing party.

Phipps v. N.V. Nederlandsche Amerikaansche Stoomvart, Maats (9th Cir. 1958), 259 F. 2d 143.

A directed verdict is not proper when the evidence is conflicting or insufficient to support only one certain verdict.

Courtney v. Custer County Bank (9th Cir. 1952), 198 F. 2d 828.

In the present cause, it is submitted, that the evidence adduced during the jury trial portion would not rationally support a verdict in favor of Appellees had the jury taken a view of the evidence most favorable to Appellant. It is further submitted that the Court did not extend to Appellant all favorable inferences that could have been drawn from the evidence.

This Honorable Court's attention is respectfully directed to the argument of counsel before the District Court, in connection with the motion for directed verdict [D.C. Tr. p. 145, line 2, to p. 154, line 10]. It should be specifically noted that when counsel for Appellant, in argument to the Court, reflected upon the disparity in Mr. Giovannoni's testimony as to the return of a check for insufficient funds, the Court stated:

"Thats for the jury." [D.C. Tr. p. 152, line 14].

The testimony of Mr. R. E. Allen, Receiver appointed by the California Superior Court, supplies ample evidence, at least sufficient to go to the jury, as to the solvency of Appellant and of her ability to pay her debts as they became due. Mr. Allen testified that on or about March 22, 1963, he took possession of the assets and properties of Appellant which he described as 71 parcels of real property and 25 Promissory Notes. [D.C. Tr. p. 50, line 20, to p. 51, line 16] and that the gross value of said parcels of real property was approximately $550,000.00, with an equity of approximately $150,000.00 [D.C. Tr. p. 58, line 20, to p. 59, line 8]. He further testified that he actually received $30,000.00 net realization from the equity [D.C. Tr. p. 60, lines 10-13]. The State Court Receiver commenced

to collect rents on these properties at the rate of approximately $5,000.00 per month [D.C. Tr. p. 61, lines 14-19]. Mr. Allen further testified that during the course of his receivership that he had not received a claim by any creditor of Appellant. [D.C. Tr. p. 67, lines 7-24].

Myrtle Athey called as a witness on behalf of Appellees, under cross-examination by counsel for Appellant, testified that on March 13, 1963, the date of the first alleged act of bankruptcy, that there existed a balance in the bank account of Appellant in the sum of $4,-081.41 [D.C. Tr. p. 115, lines 22-25] and that even on March 14, 1963, the day after the alleged act of bankruptcy, Appellant had funds in her account, but for an incorrect debit memo which had been debited by the bank, and later recredited to the account [D.C. Tr. p. 117, lines 9-17].

Mrs. Athey further testified that she had no knowledge of any other bank accounts which Appellant may have had at any other banking institutions and in fact was only apprised of the balance in the one particular account at her bank [D.C. Tr. p. 115, lines 11-21].

The testimony of Rebecca Hazel, upon cross-examination, indicated clearly that the payment which was due to her in March was in fact made and received by her on or about March 8, 1963, although the same was not due until March 12, 1963, and that she did not attempt to deposit the same for more than one month later, to wit, the month of April, 1963, at which time the same was returned for insufficient funds [D.C. Tr. p. 131, lines 7-25]. It is therefore submitted that the testimony of Rebecca Hazel in no way enforces Appellees' contention that Appellant was unable to pay her

debts as they became due on March 13, 1963, as there was no attempt by the witness to deposit the check at that time. That in fact, had the check been deposited by her on or about March 8, 1963, the date in which it was received, there was substantial funds in the account at that time [D.C. Tr. p. 115, lines 22-25].

The testimony of John J. Giovannoni on cross-examination again reflects the substantial issues to be decided by the jury in this matter. Mr. Giovannoni testified that he received his March payment from Appellant approximately the 5th or 6th of March and deposited the same in his bank. That a few days thereafter it was returned from his bank with a notation of insufficient funds [D.C. Tr. p. 138, line 10, to p. 139, line 19]. However, the evidence is clear that Mr. Giovannoni did not specifically recollect whether he made a deposit of the check in the month of March, 1963, or April, 1963, and did not specifically recall whether the check was returned to him for insufficient funds in the month of March or April, 1963 [D.C. Tr. p. 141, lines 8-15]. Counsel for Appellant submitted Exhibit 28 for Mr. Giovannoni's inspection, the bank statement of the Security First National Bank, which did not reflect the return of any check for insufficient funds, except one dated April 4, 1963 [D.C. Tr. p. 140, lines 10-25].

During the course of cross-examination the witness indicated his desire to look at the check, however, the statement of counsel for Appellees indicated that the

check was apparently missing although the witness had indicated that he had given the same to counsel [D.C. Tr. p. 141, line 19, to p. 142, line 3]. It was, therefore, impossible to substantiate the precise date on which the check was returned from the bank for insufficient funds if in fact it was, although the bank statements of Security First National Bank for the months of March and April, 1963, reflected only the return of one check on April 4, 1963, substantially after the date of March 13 or 22, 1963, which are the determining dates insofar as the insolvency or inability of Appellant to pay her debts as they become due is concerned.

It is thus respectfully submitted that there was a total lack of evidence by Appellees of Appellant's inability to pay her debts as they matured on the dates of March 13 and March 22, 1963, and that neither the overwhelming weight of the evidence nor any inferences to be drawn therefrom created a sufficient presumption to direct a verdict and take the decision away from the jury. Reasonable men could have come to a different conclusion than that reached by the Court and therefore, the Court's directed verdict was improper, created substantial error and deprived Appellant of her right to a jury determination of this cause.

V.
Conclusion.

It is submitted, based upon a review of the Specification of Errors, and Argument in connection therewith, that Appellant should not have been adjudicated a bankrupt and that the Petition of Appellees for Involuntary Bankruptcy should have been denied. That Appellees had participated knowingly and voluntarily in a series of usurious transactions in violation of California law and therefore sought relief before the Bankruptcy Court as a Court of Equity with Unclean Hands.

That Appellant has been denied Due Process of Law pursuant to the Constitution of the United States in that she was not permitted to appear and be present for either the non-jury trial before the Special Master or the jury trial before the District Court as a result of her incarceration by the California State authorities.

It is further suggested that the shifting of the burden of proof from Appellees to Appellant on the question of the insolvency of Appellant was improper in that Appellant at no time was ordered to deliver her books and records to the Bankruptcy Court. That the requirement of attendance of Appellant at the trial before the District Court and the production of her books, records and documents at that time, was in fact a denial of due process of law as the Court was fully apprised at that time that the United States Marshall had been unable to deliver her to the Courtroom for trial despite his order for Writ of Habeas Corpus Ad Testificandum and that the California State authorities refused to comply with the Writ ordered by the Judge of the District Court and refused to deliver Appel-

lant to the United States Marshal for her attendance at trial.

It is additionally submitted, as specified in the Specification of Errors, that the findings of the Special Master, each of which were objected to, and which objections were overruled by the District Court, were erroneous and that there is a complete dirth of evidence reflecting that the notes and deeds of trust in question were executed by Appellant or that they bore her name nor was any evidence adduced substantiating debts or obligations due or owing from Appellant to Appellees.

It is thus respectfully submitted that the judgment of adjudication of bankruptcy be reversed and that the Involuntary Petition in Bankruptcy of Appellees be ordered dismissed.

Respectfully submitted,

HOWARD L. THALER,
Attorney for Appellant.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HOWARD L. THALER

APPENDIX A.

Exhibit No.	Description	For Identification S.M. Tr. page	In Evidence page
1.	Letter addressed to Dolores K. Lopez from H. M. Faucher dated 11-20-60	21	21
2.	Promissory Note, deed of trust, Policy of title, Pena	22	22
3.	Photocopies of two checks: Check #201074 in the sum of $4,000 First Federal Savings and Check #537 in the sum of $555.56 made payable to Mrs. H. M. Faucher	25	135
4.	Letter addressed to Mrs. Dolores Knoll Lopez dated 5-1-62 from H. M. Faucher	26	26
5.	Photocopy of Check #0721271 dated 8-27-62 in the sum of $2,500 made payable to H. M. Faucher	27	134
6.	Note and deed of trust	28	28
7.	Letter addressed to "Luisa" dated 4-30-57 on stationery with heading "H. M. Faucher"	99	99
8.	Promissory note, deed of trust, policy of title insurance dated 3-20-57—Lot 85, $2,500	101	101
9.	Promissory note, deed of trust, policy of title insurance dated 3-20-57—Lot 83, $2,500	102	102
10.	Promissory note, deed of trust, policy of title insurance dated 3-20-57—Lot 84	107	107
11.	Three payment books re trust deeds	108	108
12.	Cancelled check #62 dated 4-6-57 to H. M. Faucher in the sum of $6,750	109	109

Exhibit No.	Description	For Identification S.M. Tr. page	In Evidence page
13.	Note, deed of trust, policy of title insurance and payment book Lot 134 dated 4-18-57	113	113
14.	Letter dated 12-3-60, note, deed of trust, policy of insurance dated 10-28-60—Lot 39. Note, deed of trust, policy of title insurance dated 10-28-60 —Lot 38		
	Check book and Statement of Account	120	120
15.	Two check register booklets and Statement of Account with Bank of America	131	131
16.	Statement of Account dated 4-10-62 note, deed of trust, policy of title insurance dated 2-1-62—Lot 7	178	178
17.	Note, deed of trust, policy of title insurance, dated 7-12-58. Lot 183 receipt in the sum of $4,050. Cancelled check dated 7-23-58 #249 made payable to H. M. Faucher in the sum of $1,750.		
	Depositor's record and payment record	225	225
18.	Note, deed of trust, policy of title ins. dated 1-7-61—Lot 135		
	Payment record	228	228
19.	Note, deed of trust, policy of title ins. dated 1-11-60—Lot 8	231	231
20.	Statement of Accounts with Security First National Bank and California Bank; Check stubs for California Bank	232	232
21.	Agreement	239	239
22.	Photocopies of two grant deeds (certified)	318	—

Exhibit No.	Description	For Identification S.M. Tr. page	In Evidence page
23.	Blank policy of title ins.	359	359
24.	Guaranteed chain-of-title report #6295644	365	365
25.	Guaranteed chain-of-title report #6295643	368	368
26.	Guaranteed Chain-of-title report #6295645	376	376
27.	Signature card—Security First National Bank — H. M. Faucher	383	383
28.	Security First National Bank ledger sheets	439	—
29.	Reporter's transcript of hearing held on 8-16-63 and 8-23-63 (excerpts)	439	439

No. 22096

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HENRIETTA M. FAUCHER, aka H. M. FAUCHER,

Appellant,

vs.

DOLORES KNOLL LOPEZ, LOUISE M. GIOVANNONI, and JOSEPH E. HAZEL,

Appellees.

APPELLEES' BRIEF.

FILED

FEB 14 1968

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Appellees.

APPELLEES' BRIEF.

Statement of the Case.

Appellees, do not believe appellant's statement of the case is adequate or accurate and sets forth their own statement.

On May 13, 1963 Appellees filed an involuntary petition in bankruptcy against the alleged bankrupt. On August 23, 1963 H. M. Faucher filed an answer, affirmative defenses and counterclaim and a demand for a jury trial. Among other things, the alleged bankrupt denied she was insolvent at the time the alleged acts of bankruptcy occurred.

Therefore, pursuant to Section 3(d) of the Bankruptcy Act, (11 U.S.C. Sec. 21(d)) the Referee in bankruptcy, Joseph J. Rifkind, ordered her to appear before him, with all of her books, papers, and accounts and to submit to an examination and give testimony

on the issue of solvency or insolvency. This hearing took place before the Referee on August 16 and 23, 1963, and at that time the alleged bankrupt invoked the privilege of the Fifth Amendment of the Constitution of the United States and refused to testify. [See Ex. 29, S. M. Tr. p. 439, S. M. Report, R. 362, lines 19-29.]

Subsequently, Irving I. Bass, the Bankruptcy Court Receiver, on November 26, 1963 filed a motion before the Honorable Pierson Hall for an order requiring the alleged bankrupt to turn over all of her books, records and documents to him as custodian of her property. The alleged bankrupt again resisted upon the grounds that her books, records and documents, contained information which might tend to incriminate her and were thus privileged under the Fourth and Fifth Amendments to the Constitution of the United States. Judge Hall denied the motion Irving I. Bass upon the grounds the books and records were privileged. [R. pp. 355-356, lines 13-32, lines 1-3.]

On December 12, 1963, Appellees then filed Request for Interrogatories seeking information concerning appellant's financial condition and to locate the whereabouts of her books and records. [R. 232.] Again, the bankrupt resisted answering the interrogatories upon the grounds the information was privileged as self-incriminating. [R. 234.] On December 23, 1963, the Appellees filed a motion for an early trial date, under Section 18(d) of the Federal Bankruptcy Act (11 (U.S.C. Sec. 41(d)). [R. 243.] On March 3, 1964 Appellees served further interrogatories upon the appellant and received further objections upon the same grounds of privilege. On April 7, 1964 appellees

filed a motion for judgment on the pleadings and to enter the bankrupt's default. All of the matters were heard April 20, 1964 and Judge Yankwich, then the Judge assigned to the case, ordered the Appellant to answer the interrogatories within 10 days and continued the hearing. Since a trial date was approaching, Appellees further filed, on June 12, 1964, Request for Admissions, which the Appellant refused to answer on the usual grounds of privilege against self-incrimination. Appellant, on June 18, 1964 filed a motion for a Protective Order, which was heard by Judge Yankwich on June 22, 1964.

Judge Yankwich granted the Appellant's motion and set the matter for trial on June 23, 1964. On June 23, 1964 the morning of the jury trial, Judge Yankwich, upon the motion of Appellant granted an indefinite continuance to Appellant, over the vigorous objections of Appellees. On motion of Appellees the matter was then transferred to Judge Albert Lee Stephens, Jr. On July 15, 1964, Appellees filed a Motion for Sanctions under FRCP 37, and another motion for an early trial date before Judge Stephens.

These motions were all taken under submission by Judge Stephens and later on September 11, 1964, all were denied.

On November 13, 1964, Appellees moved for the appointment of a Special Master, on both the non-jury and jury issues of the case. At that time Judge Stephens denied the motion for a Special Master but set the matter for pre-trial hearing. On February 8, 1965, the Appellees filed their Memorandum of Contentions pursuant to Local Rule 9. [R. 270.] At the hearing on the pre-trial Judge Stephens reconsidered

his earlier ruling, and referred to non-jury issues to Referee Rifkind as Special Master. This ruling was incorporated in his Pre-Trial Order date April 7, 1966.

Prior to the hearing before Referee Rifkind and on April 26, 1966, as Special Master, Appellees served a Notice To Produce upon Appellants, but no books, records, ledgers or any other documents were produced at the hearing. [R. p. 300.] On August 12, 1966, the Special Master after three days of testimony and argument commencing May 23, 1967, filed his report, together with his findings of fact and conclusions of law on the non-jury issues. [R. 350-358.]

Appellant filed objections to the Special Master's report with Judge Stephens on August 18, 1966. [R. p. 361.] However no transcript of the testimony of the hearing was supplied to Judge Stephens, and these objections were overruled and the report was approved with one modification. [R. 387-388.] The matter was then set for trial of the jury issues in January, 1967, but continued until May 2, 1967. After hearing the evidence, and the arguments Judge Stephens entered a directed verdict for Appellees. This directed verdict affirmed the Special Master's Report and adjudicated Appellant a bankrupt. [R. 396-399.]

The Appellant then filed a motion for a new trial on May 12, 1967, which was opposed by Appellees and denied by the court.

Alleged Specification of Errors.

I.

Appellant cites no authorities for her contention that certain errors occurred in referring the non-jury issue to a special Master, and in the proceedings before the

Special Master and the District Court Judge. Nevertheless, Appellees will respond to the specifications by referring to the record before the court.

REFERENCE TO SPECIAL MASTER WAS PROPER.

This appellate court should note that in a trial upon an involuntary petition in bankruptcy, the alleged bankrupt is entitled to a jury trial *only* upon the issue of insolvency, pursuant to Section 19(a) of the Bankruptcy Act. (11 U.S.C. 42a.)

> *In re Airmont Knitting and Undergarment Co.,* 182 F. 2d 740 (2 C.A. 1950);
>
> Moore's Federal Practice, Vol. 5, Sec. 38.30 [2] pp. 215-217.

In the event no jury trial is demanded then the hearing on the adjudication is normally held before the Referee in Bankruptcy, pursuant to the usual order of reference from the Judges of the U.S. District Court.

> Moore's Federal Practice, Vol. 5, Sec. 53.12 [6] pp. 2990-2993.

The reference of the nonjury aspects of the cause to a special Master was proper. On November 13, 1964, the Appellees filed a Notice of Motion and Application for Appointment of Special Master with Judge Stephens. He initially denied the application, but after it became clear the matters to be litigated were enormously complicated, and involved matters of Account as defined in Federal Rules of Civil Procedure 53(b). Judge Stephens reconsidered his earlier ruling and in his Pre-Trial Conference Order of April 7, 1966, referred the non-jury issues to Joseph J. Rifkind as Special Master pursuant to Rule 53(e)(2) of the Federal Rules of Civil Procedure. [R. 35, lines 22-25.]

It is evident from the Memorandum of Contentions of Fact and Law of Petitioning Creditors Pursuant to Local Rule 9 [R. 270-287] just how complicated and exceptional the issues were.

It should be pointed out Appellant never urged any reasons for her objection to the reference to the Special Master. The usual reason of additional expense was not valid, since the Special Master appointed was a Referee in Bankruptcy whose court and Reporter were readily available at no extra cost.

The reviewing court should remember that neither the Judge nor Appellees were sure whether or not the missing books would suddenly appear at the trial to refute the creditors' figures. A hearing before a Special Master was a far more flexible forum for such an unexpected event and would not necessarily result in a postponement or mistrial. Finally there appears to be a more liberal policy in referring bankruptcy matters to Special Masters, than in other types of cases.

In re Joslyn's Estate, 171 F. 2d 159, 164 (7 C.A. 1948);

Moore's Federal Practice, Vol. 5, Sec. 53.05[2] p. 2939.

Appellant Has No Constitutional Right to Attend Civil Trial.

Appellant has repeatedly contended that it was incumbent upon either the Referee, the Special Master, the District Judge and/or the United States Marshal to secure the presence of the Appellant at the trial and the hearing and that the failure of these parties and/or all of them to do so, somehow contributed to a denial of due process.

In Point II, Appellant refers to this "Exclusion" from the trial. Inasmuch as the authorities contained in Appellant's Point II relate to the specification in error in Sub. (b), Appellee will deal with them here.

The Special Master deals with Appellant's assertion that she should have been present at the hearing, starting on line 7, page 3 through line 21, page 5 of his report. [R. 352-354.]

Judge Stephens offered to hold trial at the prison if counsel for Appellant could give some assurance that some useful purpose could be accomplished as described in Findings of Fact II by Judge Stephens. [R. 379, lines 7-28.]

The Appellant contends that there was a "violation of the Order of Writ of Habeas Corpus Ad Testificandum", because she was not delivered to the courtroom. From this alleged "violation" she asks the court to draw another inference to the effect that she was deprived of a "right to be present at the trial". No right of Mrs. Faucher was violated since no such right exists.

The alleged bankrupt is confusing this involuntary bankruptcy proceeding with a criminal prosecution, in which the defendant would have certain rights guaranteed by the Sixth Amendment of the Constitution of the United States.

> In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witness

against him; to have compulsory process for obtaining Witnesses in his favor, and to have the Assistance of Counsel for his defense.

However, even these Constitutional guarantees have their limits. The Supreme Court of the United States has held that where the guilt of the defendant is in issue, as in a criminal trial, his presence is required by the Sixth Amendment, but that mere existence of the power to produce a prisoner in a *habeas corpus* proceeding does not mean that the prisoner should be automatically produced in every such proceeding.

United States v. Hayman, 342 U.S. 205, 72 S. Ct. 263, 96 L. Ed. 232 (1952).

A Writ of Habeas Corpus Ad Testificandum is a discretionary writ.

Title 28, U.S.C., Sec. 2241;

Gilmore v. U.S., 129 F. 2d 199 (10 C.A. 1942), Cert. den. 317 U.S. 631, 63 S. Ct. 55, 87 L. Ed. 509;

Cukovich v. U.S., 170 F. 2d 89 (6 C.A. 1948), Cert. den. 336 U.S. 905, 69 S. Ct. 484, 93 L. Ed. 1070.

Since the alleged bankrupt has no absolute right to even the issuance of such a writ, she certainly has no absolute right to be present by the issuance of said writ. The courts in an analogous situation have declined to issue a requested Writ of Habeas Corpus Ad Testificandum requiring the appearance of a witness incarcerated in a state prison where it ascertained the witness would claim the Fifth Amendment.

Murdock v. U.S., 283 F. 2d 585 (10 C.A. 1960), cert. den. 366 U.S. 953, 81 S. Ct. 1910, 6 L. Ed. 2d 1246.

The Appellant has not been deprived of any right to be heard. She has at all times been represented by counsel and has had innumerable opportunities to testify either by deposition or otherwise during the four years the case was pending.

If Appellant's argument was correct and a person was guaranteed the absolute right to be present at a civil trial in which she was a defendant, then no plaintiff could ever obtain a default judgment against an absent defendant. This clearly is not the law.

II.

The Findings of the Special Master are all amply supported by the record:

Finding No. 1—R. 357-358

It is clear that Mrs. Faucher sold fictitious notes, trust deeds and title insurance policies to the petitioning creditors, for which they paid valuable consideration.

Mrs. Daniel Lopez—S.M. Tr. p. 20, lines 9-26, Ex. 1; pp. 21-23, Ex. 2; pp. 25-26; Exs. 3 and 4; pp. 27-31, p. 133, Exs. 5 and 6; pp. 69-71; Exs. 1-2; pp. 81-85, p. 91, lines 14-26.

Mr. and Mrs. Giovannoni—S.M. Tr. pp. 95-99, Ex. 7; pp. 100-101, Ex. 8; pp. 101-102, Ex. 9; pp. 102-107, Ex. 10; pp. 107-108, Ex. 11; pp. 108-109, Ex. 12; pp. 109-113, Ex. 13; pp. 113-120, Ex. 14; pp. 121-131, Ex. 15; pp. 138-139, p. 150, lines 19-23, pp. 176-180, Ex. 16; pp. 180-190; pp. 216-218.

Mr. and Miss Hazel—S.M. Tr. pp. 222-225, Ex. 17; pp. 226-231, Exs. 18 and 19; pp. 231-232, Ex. 20; pp. 234-235; pp. 236-239, Ex. 21; pp. 240-260; pp. 282-294.

Finding No. 2—R. 358

The obligations are unsecured and are debts of the alleged bankrupt—S.M. Tr. pp. 307-330.

Finding No. 4—R. 358

The legal basis of this finding is discussed in detail in Points I, II, III and IV of this brief. Reference is made therein to Exhibits No. 2, 13 and 14.

Finding No. 5—R. 358

The legal basis of this finding is discussed in detail in Point IV of this brief. The evidence supporting this finding is found in S.M. Tr. pp. 20-379, Ex. 1-26.

Finding No. 6—R. 358

The legal basis of this finding is discussed in detail in Points V and VI of this brief. The factual basis is Exhibit 29.

Finding No. 7—R. 358

The legal basis for this finding is discussed in detail in Point I, II and III of this brief. The Exhibits clearly show only Exhibits 2, 13 and 14 could be construed as usurious. The testimony shows no amounts in excess of 10% of the principal were ever received by the petitioning creditors within any one year. S.M. Tr. pp. 21-26, pp. 108-131.

III.

(a) No error in law occurred in the trial before the District Court prejudicial to the alleged bankrupt. If any error occurred it was in her favor. Point V of this brief, together with Exhibit 29, clearly demonstrates that the burden of proof upon the issue of insolvency shifted to the alleged bankrupt on August 16,

1963. On that day she appeared before Referee in Bankruptcy, Joseph J. Rifkind, pursuant to Section 3 (d) of the Bankruptcy Act (11 U.S.C. Sec. 21d) and admitted having books and records relating to her business, but failed to produce them for examination, and refused to disclose their whereabouts.

The District Court actually allowed her additional time to produce them by giving her until the trial on May 2, 1967. Her civil disability on that date was no excuse, since she was not imprisoned on August 16 and 23, 1963, when she should have produced them.

(b) A directed verdict was proper under the circumstances of the trial. This is discussed in detail in Point VI of this brief and is fully supported by the testimony presented at the trial. [D.C. Tr. pp. 4-179.]

POINT I.

Appellees' Claims Against Appellant Are Not in Violation of the California Usury Laws.

The majority of the instruments are not usurious, even when the amount of the discount or bonus is added to the interest provisions. Only the promissory notes contained in Exhibit "2" payable to Mrs. Lopez, and the two Promissory notes in Exhibits "13" and "14" payable to the Giovannoni's provide for a 10% interest rate. All the remaining notes provide for either a 7% or a 7.2% interest rate. If the amount of discount is prorated over the term of the 7% and 7.2% notes, the interest rate received upon the sums actually paid by the creditors does not exceed 10%.

That is, 10% of the amounts actually paid for the notes (*e.g.* 10% of $3,000.00 in Exhibit "19" equals

$300.00), is still greater than 7% of the face amount of the note, which includes the discount (*e.g.* 7% of $3,333.33 equal $233.33). Thus, only Exhibits "2", "13", and "14" can be construed as usurious, if the court looks behind the face of the notes.

However, in each of the 10% notes, the payments made were all credited to interest only, and no amounts were ever credited to principal. Thus, the entire defense of usury boils down to the legal effect of those three promissory notes. And since the last payments were not made on those notes, the amount of interest paid up until the date of the institution of these proceedings, even on the 10% notes, did not exceed the maximum rate available for the term of the note.

POINT II.

Usury Is Not a Defense Available to Mrs. Faucher.

1. Appellees' claims against Mrs. Faucher are based upon rescission of the contracts of sale of the notes and trust deeds to them by Mr. Faucher. The Appellees are not seeking to enforce any of the usurious notes against any of the ostensible payees thereon. On the contrary, Appellees want their money back, since Mrs. Faucher did not deliver what they bargained for. Thus, the issue of usury does not arise, because the Appellees simply have credited all amounts received against the principal amount actually advanced by them for the notes.

Gregg v. Phillips, 105 Cal. App. 132, 286 Pac. 1071 (1930).

Nor did the petitioning creditors receive any greater sums of money from Mrs. Faucher than allowed by law. The Pre-Trial Order expressly finds that the creditors have claims above the purisdictional amount. The Ap-

pellant cannot claim offsets or treble damages sufficiently large to discharge her obligations entirely.

2. If the notes are usurious and are tainted with illegality then this is another ground to rescind the transaction, pursuant to California Civil Code Section 1689, under either mistake of law, or failure of consideration. Mrs. Faucher sold the instruments to Appellees as good, valid, and legally enforcible notes. If they are not, because they violate the law, then she should return the creditors' money.

3. Mrs. Faucher is not a party to the instruments, and thus the defense of usury is not available to her (with the exception of Exhibit 16). Only a party to an instrument can raise the defense of usury since it is personal to the borrower.

Zimmerman v. Boyd, 97 Cal. App. 406, 275 Pac. 507 (1929).

Since Mrs. Faucher received money for notes upon which she did not choose to bind herself, she cannot now take advantage of defenses available to her only if she had so obligated herself.

POINT III.

The Appellees Do Not Have Unclean Hands.

The record of this case clearly demonstrated beyond the slightest doubt that Mrs. Faucher was for many years engaged in the business of selling fictitious promissory notes and forged deeds of trust and title insurance policies to the Appellees. [R. 356, lines 6-31.]

The Appellant's major defense seems to be that since the Appellees were duped into participating in these transactions, and gulled into buying forged and fic-

titious instruments which might be construed as usurious, that therefore they are barred from any equitable relief. The absurd contention finds no support in the law.

Appellant has not cited one case, which holds that a lendor under a usurious agreement was deemed to have unclean hands. The authorities are all to the contrary. California law is not so severe as to declare any usurious contract totally void, thus depriving the lendor ever of the right to collect the principal.

> *Haines v. Commercial Mortgage Co.,* 200 Cal. 609, 254 Pac. 956, 255 Pac. 805, 53 A.L.R. 725 (1927).

California law simply invalidates totally the interest provision of the usurious agreement.

> *Moore v. Russell,* 114 Cal. App. 634, 300 Pac. 479 (1931);
> 49 Cal. Jur. 2d, *Usury,* Sec. 12, p. 675.

If Appellant was correct, then every usurious contract would be automatically void and unenforceable, *in toto,* since every lender would be barred from collecting upon the principal of the note. This clearly is not the law. Indeed, any lendor may simply obviate the defense of usury, by waiving his right to anything other than what is due him on the principal.

> *Gregg v. Phillips,* 105 Cal. App. 132, 286 Pac. 1071 (1930).

This is in effect what Appellees have done by seeking to rescind their contracts with Appellant.

POINT IV.

Appellant Is Estopped to Claim Appellees Have Unclean Hands.

The record is devoid of any evidence that Appellees were ever aware that the promissory notes provided for a usurious rate of interest. Since the record also clearly demonstrates that she falsely and fraudulently, sold the notes to Appellees, she should be estopped from raising the defense of usury.

Stock v. Meek, 35 Cal. 2d 809, 221 P. 2d 15 (1950);

Martin v. Ajax Construction Co., 124 Cal. App. 2d 425, 269 P. 2d 132 (1950);

Paillet v. Vroman, 52 Cal. App. 2d 297 (1942);

Ryan v. Motor Credit Co., 130 N.J. Eq. 531, 23 A. 2d 607, 611 (1941), 132 N.J. Eq. 398, 28 A. 2d 181, 142 A.L.R. 640 (1942).

The *Ryan* case is on all fours with the case at hand and was cited, with approval in the *Stock* case. In *Ryan* the borrower duped the lender into making nearly 500 small loans, using the names of fictitious nominees. The court held that the fiction or presumption that a borrower under a usurious contract is not *in pari delicto* with the lender, could not stand up against the overwhelming facts of that case, and held the borrower estopped to assert a claim of usury.

POINT V.

The Burden of Proof Upon the Issue of Insolvency Was Upon the Appellant.

The Bankruptcy Act provides that when insolvency is in issue, the petitioning creditors, shall be assisted in carrying this burden of proof by requiring the debtor to "appear in Court on the hearing and prior thereto if

ordered by the Court, with his books, papers, and accounts and submit to an examination and give testimony as to all matters tending to establish solvency or insolvency".

Bankruptcy Act, Sec. 3(d);

11 U.S.C. Sec. 21(d);

Collier on Bankruptcy, Vol. 1, Sec. 3.208(2), p. 456 (14th Ed. 1961).

If the bankrupt refuses to appear with his books, papers, and accounts for examination, then the burden of proving his solvency at the time of the transfer is shifted to him.

Bogen & Trummel v. Protter, 129 Fed. 533, 12 A.B.R. 288 (CA 6 1904);

In re Wilson, 16 F. 2d 177, 9 A.B.R. (N.S.) 63 (C.A. 7 1926);

Collier on Bankruptcy, Vol. I, Sec. 3.208 [2] pp. 456-457 (14th Ed. 1961).

The leading case upon this issue is the *Bogen* case, interpreting the 1898 Bankruptcy Act, whose Section 3(d) was substantially identical to the present one. The bankrupt had denied he was insolvent and had asked for a jury trial upon the issue. The trial judge declined to hold that the bankrupt's failure to appear at the trial with his books, papers, and accounts, shifted the burden of proof to him and directed a verdict in his favor. In reversing the lower court's decision, the Sixth Circuit stated:

> "The law expects a merchant charged with bankruptcy, to support his statements by his books, which speak for themselves. If he submits to examination and produces his books, and his insolvency does not appear, the burden is upon the

petitioners to make the proof, but if he fails to appear for examination, or fails to produce his books, the burden is upon him to prove his solvency. In this case, the testimony showed the sales-book for 1902 was on hand just before the fire. It disappeared after the fire, although it was not burned up. So with the other books. No satisfactory explanation of their disappearance was furnished. It is not sufficient for an alleged bankrupt, when called upon to produce his books, to say, 'I don't know where they are'. It is his business to know where they are. They are the only proper proof of his financial condition. He must not only keep proper books of account, but preserve them, and produce them when called upon. He fails to do so at his peril. The court should have held that, under the circumstances, the burden of proving his solvency rested upon Protter."

The *Wilson* case was also decided under the 1898 Bankruptcy Act. Wilson, the bankrupt, refused to appear at the examination, or testify or produce his books, papers and account. No reason for this refusal is set forth, but it appears that the court felt that any alleged bankrupt had the absolute right to so refuse. Wilson did attempt to prove his solvency through the testimony of his auditor. The court held that this testimony was secondary and therefore not admissible. The court noted that the auditor testified only as to the existence of certain assets as set forth on Wilson's books, and stated

> "There is little else except some evidence as to a few items of his property, but none as to his liabilities, a subject which generally, speaking, is *peculiarly within his own knowledge.*" (emphasis added).

This ruling has great significance when the court remembers the only testimony introduced by the Appellant, was that of Roy Allen, the state court receiver. He admitted he was only able to testify as to Appellant's assets, but not her liabilities, and thus Judge Stephens was free to ignore his testimony. [D.C. Tr. p. 82, lines 2-23.]

The leading decision in this circuit is *Hollister et al. v. Oregon Hardwood Mills,* 15 F. 2d 787, 9 A.B.R. (N.S.) 137 (C.A. 99 1926). The issue on appeal was whether the insolvency of the bankrupt had been established. The court cited Section 3 of the old Bankruptcy Act, to find that the bankrupt's president's testimony was so unsatisfactory as to shift the burden of proof to the bankrupt corporation.

> "The testimony concerning the indebtedness owing and the claims of the original and intervening creditors clearly indicates that no reliable data were furnished by the corporation. The provisions of the act quoted obviously make it the duty of the debtor to render reasonable assistance in the manner indicated by furnishing information concerning his financial condition—being a matter *peculiarly within his knowledge*—in order to determine the question of his solvency or insolvency." (emphasis added).

The statute does not require that the failure to produce books and papers be willful or contumacious in order to throw upon the bankrupt the burden of proving his solvency; the failure to produce, and the absence of a satisfactory explanation is sufficient.

> *Collier on Bankruptcy,* Vol. I, Sec. 3.208 [2] p. 457 (E.D. N.Y. 1932).

In the *Matter of Cayne Construction Co., Inc.,* 58 F. 2d 664, 21 A.B.R. (N.S.) 219 (D.C. N.Y. 1932) the court found that the debtor "failed to produce satisfactory books of account; and thus had the burden of proof on the issue of insolvency shifted to it."

Likewise in *Cummins Grocery Company v. Talley,* 187 Fed. 507, 6 A.B.R. 484 (C.A. 6 1911) stated:

> "The evidence in this case does not indicate that there was any intentional refusal on the part of the respondents to produce papers and accounts relating to the item in question, nor that his failure to do so was contumacious. But the statute does not require his failure be wilful or contumacious in order to throw upon the bankrupt the burden, which is not a drastic one, of proving his solvency. The failure to make such production must be satisfactorily explained."

The Bankrupt Has No Excuse for Her Failure to Produce the Books.

The Sanction of 3(d) is not imposed if the bankrupt is unable to comply as long as they are available to the petitioning creditors. Thus, in the case of *Roberts v. Yegen,* 12 F. 2d 654, 8 A.B.R. (N.S.) 162 (C.A. 9 1926) the court refused to shift the burden of proof where the books and records were in the hands of a state court receiver. The court found that the alleged bankrupt had sufficient excuse in that they had proven they did not have custody of the records, had surrendered them earlier pursuant to a duly made order of the state court, and could not produce them. It is important to note the following statement however:

> "Petitioners were not aggrieved for the record is that they had access to and used the books of the

> Butte and Anaconda banks, and were offered access to the books at Billings and Gardiner; the judge stating that, if desired, he would appoint a special master to take testimony at the outside places. Petitioners, however, did not avail themselves of the offer."

The exception here is clear, Section 3(d) is designed to prove the fact of insolvency by the best possible means—the bankrupt's books and records. If the petitioning creditors can make an examination of the books without the bankrupt producing them, the mere inability of the bankrupt to so produce them does not shift the burden to him.

However, it is the ability to produce the records that determines if the bankrupt has shouldered the burden. Thus is *In re Desha & Willfong,* 30 A.B.R. 130 (Dist. Hawaii 1913) the sheriff had levied upon and seized all of the property of the bankrupt including the books and records. They were held on the island of Hilo, 200 miles away in the custody of a marshal. The court held this did not excuse their production by the alleged bankrupt. In citing Section 3(d) of the 1898 Act the court stated:

> "Congress has deemed it wise to provide this rule because the solvency of an alleged bankrupt is a matter peculiarly within his own knowledge, or almost always within his power to show more easily that it can be shown by anyone else. (citations) Are we, then, to raise an exception to that declared rule of policy merely because, in a case like this, it is as convenient for the petitioning creditors, or for the marshal, or the judge, as it is for the respondent himself, to get the respondent's books

into court? The question answers itself. The statuite having made it the respondent's duty to appear with his books, the burden must remain and is not shifted by the mere consideration of convenience or inconvenience. The contesting respondent Desha could have secured the presence of the books by subpoena d.t. or by other proper order of court, and it was his business to do so."

POINT VI.

The Privilege Against Self-Incrimination Embodied in the Fourth and Fifth Amendment Does Not Exempt the Bankrupt From Assuming the Burden of Proof Upon the Issue of Insolvency.

While a bankrupt may be excused from producing her books and records under a privilege, this is not to say that she escapes the procedural consequences of invoking that privilege. Actually, under all of the cases cited, the bankrupt could simply refuse to produce her books and records by invoking any reason whatsoever. If she does not produce them she simply assumes the burden of proof.

Thus in the recent cases of *In re Shulund,* 210 F. Supp. 195 (D.C. Mont. 1962) the petitioners in an involuntary bankruptcy proceeding sought an order pursuant to either Rule 34, of the Federal Rules of Civil Procedure, or alternatively for an examination pursuant to Section 21(a) of the Bankruptcy Act, (11 U.S.C. Sec. 44a) to compel production and inspection of all books, papers and records of the bankrupt, since the bankrupt had denied the allegation of insolvency and had demanded a jury trial upon the issue. The court denied the motions of the creditors upon the grounds that Section 3(d) of the Bankruptcy Act, precluded

discovery under the Federal Rules of Civil Procedure, and that the only sanction available for refusal to comply with an order to produce their records is to shift the burden of proof to them at the time of trial.

In the *Shulund* decision the Montana District Court reviewed the legislative history of Section 3(d), with Section 21(k). The court reasoned that since one of the stated purposes of the comprehensive revision of the Bankruptcy Act in 1938 was "to improve the procedural sections of the Act . . . in proceedings for discovery" . . . that therefore a relationship existed between Section 21(k) and 3(d). The court quoted House Report No. 1409 to H.R. 8016, 75th Congress, 1st Session p. 21 (1937) . . .

> "Section 21(k): This new subdivision accords with the proposed amendments to Section 3(d) with the present equity practice. It tends to reduce all expenses, speed trials, and the ready production of admitted facts, so as to save the time of court, counsel, and the litigants, particularly in jury trials of contested involuntary proceedings where often a large amount of time is unnecessarily consumed in arriving at what are the actual facts as to admitted assets and liabilities."

This reasoning and the legislative history are important since it shows that Section 3(d) is related to the Federal Rules of Civil Procedure, and is itself a procedural device. Thus while there appears to be no case precisely upon the issue of whether an invocation of the privilege against self-incrimination, excuses an alleged bankrupt from shouldering the burden of proof imposed by Section 3(d), the court may look to other cases deciding whether a claim of privilege avoids the sanctions or procedural consequences of the Federal Rules.

Rule 33 of the Federal Rules of Civil Procedure permit inquiry to the same matters as permitted by Rule 26. Rule 26 permits examination to any matter not privileged. This exclusion of privileged matters is subject to certain limitations. In answer to the rhetorical question, would it make any difference that the privilege was claimed in connection with an affirmative defense? Professor James W. Moore, author of Moore's Federal Practice, Vol. 4, Chap. 26, Sec. 26.22 (5) pp. 1295-1296, says Yes. He believes under such a circumstance the party has waived the privilege, although the party did not intend to waive it.

This theory has been followed by Judge Herlands in *Independent Prod. Corp. v. Loew's Inc.,* 25 F.R. Serv. 26b, 31, Case 2, 22 F.R.D. 266, 276-277 (S.D. N.Y. 1958).

Further on the related issue of the physician patient privilege, Judge Bryan in *Autry v. United States,* 4 F.R. Serv. 2d, (33.334.) Case 1, 27 F.R.D. 399 (S.D. N.Y. 1961).

> "The nature of this action for malpractice is such that the plaintiff cannot possibly try it without waiving his statutory privilege, if he has not done so already. If the plaintiff goes to trial without waiving his privilege the defendant would undoubtedly have the right to apply for and obtain a suspension of the trial to enable the defendant to go into the subject matter which plaintiff has claimed to be privileged and which is material and necessary in its defense.
>
> . . . .
>
> Interrogatories addressed to parties under Rule 33 of the Federal Rules of Civil Procedure may relate

to any matter not privileged which is relevant to the subject matter involved in the pending action. See Rule 26(b). But this does not mean that plaintiff can take advantage of the physician-patient privilege to prevent defendant from inquiring in pretrial proceedings as to relevant and material matters necessary to the defense. If such matters were deferred to the trial the almost inevitable result would be an interruption of the trial when the privilege had been waived by the plaintiff so as to permit the defendant to prepare its defense. In all likelihood a suspension of the trial would be impractical and it would be necessary to declare a mistrial.

Whether the rule as to privilege be governed by state or federal law the plaintiff may not continue his action and at the same time deny to defendant the right to avail itself of the pretrial procedures necessary to prepare its defense."

It is important to note that the Federal Rules specifically excluded all matters claimed privileged, whereas, no such exception is found in Section 3(d) of the Bankruptcy Act. Yet the courts have still refused to allow a claim of privilege, to avoid the procedural consequence of the burden of proof.

An Order Denying a Motion for a Turn Over of the Alleged Bankrupt's Books, Papers, and Documents Does Not Exempt Her From the Procedural Sanction of Section 3(d).

The order of Judge Pierson Hall denies the motion of Irving I. Bass, Mrs. Faucher's Federal Bankruptcy Receiver, to compel a turn over of the books, papers and records. Appellees submit that this order was in

error but the issue now appears moot. But has never been any order entered excusing Mrs. Faucher from permitting her petitioning creditors from examining her books.

The motion brought by Irving I. Bass, was based upon the order of the Federal Bankruptcy Court authorizing and instructing him to take custody and possession of *all* of the property of Mrs. Faucher, including her books, papers and records. Authority for this motion [R 5] for an order that such books and records must be turned over to the Receiver's custody is the case of *In re Fuller & McGee,* 262 U.S. 91, 1 A.B.R. (N.S.) 1, 32 S. Ct. 496, 67 L. Ed. 881 (1923) in which an alleged bankrupt resisted a turn over order for his records upon the grounds that they might tend to incriminate him. In denying him that privilege the court stated:

> "A man who becomes bankrupt, or who is brought into a bankruptcy court, has no right to delay the legal transfer of the possession and title of any of his property to the officers appointed by law, for its custody, or for its disposition, on the grounds that a transfer of such property will carry with it incriminating evidence against him. His property and its possession pass from him by operation and due proceedings of law, and when control or possession have passed from him he has no constitutional rights to prevent its use for any legitimate purpose. His privilege secured to him by the Fourth and Fifth Amendments of the Constitution, is that of refusing himself to produce as incriminating evidence against him anything which he owns or has in his possession and control; this privilege is respect to what was his in his

custody ceases on a transfer of the control and possession which takes place by legal proceedings and in pursuance of the rights of others, even though such transfer may bring the property into the ownership or control of one property subject to a Subpoena Duces Tecum."

Further, in the case of *Dier v. Banton,* 262 U.S. 147, 1 A.B.R. (N.S.) 602, 67 L. Ed. 915, 43 S. Ct. 533 (1922).

Judge Hand's action was based on the ruling of this court in *Johnson v. United States* (citation). He quoted the language used in the Johnson Case. "A party is privileged from producing the evidence, but not from its production". He alluded to the circumstance that in the Johnson Case, there were both title and possession in the trustee, whereas in this case the books and papers were in the hands of the receiver, who had no title, but that he said, made no difference. We agree with this view, and held that the right of the alleged bankrupt to protest against the use of his books and papers relating to his business as evidence against him ceases as soon as his possession and control over them pass from him by the order directing their delivery into the hands of the receiver and into the custody of the court. This change of possession and control is for the purpose of properly carrying on the investigation into the affairs of the alleged bankrupt, and the preservation of his assets pending such investigation, the adjudication of bankruptcy *vel non,* and if the bankruptcy will not be sustained, and in that case the alleged bankrupt will be entitled to a return of his property, including

his books and papers and when they are returned he may refuse to produce them and stand on his constitutional rights. But while they are, in the due course of the bankruptcy proceedings, taken out of his possession and control, his immunity from producing them, secured him under the Fourth and Fifth Amendments, does not inure to his protection. He has lost any right to object to their use as evidence because, not for the purpose of evidence, but in the due investigation of his alleged bankruptcy and the preservation of his estate pending such investigation, the control and possession of his books and papers relating to his business were lawfully taken from him.

It is pressed upon us that the bankrupt may prevent the use of such books and papers taken over by a receiver in the bankruptcy proceedings for evidence in a criminal case in the state court by resisting surrender and protesting against their use for such a purpose at the time the receiver took possession. But we think the alleged bankrupt has no such right. We so held in the Matter of *Fuller* decided April 30, 1923 (citation) in which it was sought to attach conditions of this kind to the turning over of the books and papers of a bankrupt to the trustee in bankruptcy. We are of opinion that the same principle must apply to the delivery of the books and papers relating in the estate into the custody of the receiver of the bankruptcy court.

Counsel still believes that Judge Hall was in error in implicitly overruling the two Supreme Court cases, but could not, of course, appeal from his interlocutory order.

Appellees Established Appellant's Insolvency by Direct Testimony.

In re Eastern Supply Co., 197 F. Supp. 359 (W.D. Pa. 1961) is the mirror image of our case at hand. There, as here, an involuntary petition in bankruptcy was filed alleging the fifth act of bankruptcy, *i.e.* the appointment of a State court receiver while insolvent. There, as here, the alleged bankrupt denied insolvency and demanded a jury trial. At the trial before a Referee sitting with a jury the petitioning creditors offered testimony to show that they had demanded payment upon their debts which was refused, and read into the record, depositions of a collection agency, that had unsuccessfully attempted to collect from the alleged bankrupt. At the end of the petitioning creditors' case, the alleged bankrupt moved for a directed verdict which was refused. The alleged bankrupt offered no defense and the court adjudicated the debtor as a bankrupt.

In sustaining the decision of the referee the court held that insolvency in the equity sense, *i.e.* inability to pay one's debts as they mature, could be proven by inference, citing *In re Wilson,* 16 F. 2d 177 (C.A. 6 1926). The appellate court also pointed out that the alleged bankrupt, had not kept its books up to date, and had not met the duty of producing informative testimony concerning its financial condition, imposed by Section 3(d) of the Bankruptcy Act. The court stated:

> "We believe that the unexplained failure of the partnership and the individual partners to maintain and produce at tbe trial *adequate* books and accounts, or informative testimony, from which an accurate determination of the financial condition of the partnership, as of March 24, 1958,

could be made; shifted to the partnership the burden of proving that the partnership had sufficient money available to pay, as of that date, the partnership debts as they matured, and created a presumption of insolvency in the equity sense which in the absence of proof to the contrary by the partnership and its partners was sufficient in itself to justify the special verdict. Indeed when the partnership decided not to offer any evidence in its defense, had an appropriate motion been made, the Referee might well have directed a verdict in favor of the petitioning creditors. In any event, there was sufficient evidence to sustain the jurys' verdict."

In the case at hand, the alleged bankrupt's only witness, Roy E. Allen, the state court receiver, testified that Mrs. Faucher had obligated herself to payments upon her obligations in excess of income. [D.C. Tr. p. 76, lines 3-21.]

Miss Rebecca Hazel testified she was not paid any money on the notes held by her and her father after March of 1963. [D.C. Tr. pp. 129-130.]

Mr. John J. Giovannoni testified that he received a $165.00 check upon the obligation owed to he and his wife on or about March 2, 1963, and that after depositing the check it was returned marked "insufficient funds." [D.C. Tr. pp. 133-134.]

Mr. Giovannoni further testified he attempted to contact Mrs. Faucher several times without success; telephoned her house and received no response; drove to her house knocked and received no response; inserted a letter under the door; and after some searching con-

tacted Mr. Faucher, but was never able to contact Mrs. Faucher, and never saw her again until after the institution of these proceedings. [D.C. Tr. pp. 135-138.]

Mr. Giovannoni further testified he never received his $300.00 check during or after the month of March, 1963. [D.C. Tr. pp. 142-143.]

This unrebutted testimony clearly demonstrates that on March 22, 1963, at the time of the appointments of the state court receiver, Mrs. Faucher was unable to pay her debts as they matured, and was thus insolvent for the purposes of this particular act of bankruptcy.

Bankruptcy Act, Sec. 3a (5);

11 U.S.C. Sec. 21a(5).

The foregoing is more evidence upon this issue than that presented by the petitioning creditors in the *Eastern Supply Co.* case (*supra*).

Conclusion.

It is submitted that no error occurred prejudicial to Appellant anywhere in these proceedings. Both the Referee and the U. S. District Judges leaned over backwards to be fair to the alleged bankrupt. She was ably defended in these proceedings from start to finish. From the beginning to the end of the litigation she repeatedly and continuously invoked her privilege against self-incrimination to block all efforts on the part of the petitioning creditors to locate her books and records, or to examine her concerning her assets, and liabilities.

She was ordered into court by subpena on August 16, and 23, 1963 to be examined concerning her books and records.]Ex. 29, S. M. Tr. p. 439.] She admitted she had books and records, but refused to dis-

close their location. At that time the burden shifted. The bankrupt never once, by counsel, written pleading, or otherwise, from that day forward indicated any intention of submitting her books and records to Appellees for examination or offered to testify on the issue of insolvency herself.

The fact that every Judge, Referee, and Special Master continued to offer her such an opportunity, up until the jury trial has been seized upon by her to mean, she had a right to do so, and no precedural sanction could be imposed against her until she did appear and refuse to so testify. This contention has no basis in logic or the law.

As to the findings of fact of the Special Master, these are to be accepted unless clearly erroneous.

General Orders in Bankruptcy No. 47.

Judge Stephens granted a directed verdict to Appellees because the Appellant put on no probative evidence whatsover, and the Appellees put on a *prima facie* case. Since Appellant had the burden of proof on the issue of insolvency, a directed verdict was proper.

Respectfully submitted,

RICHARD M. MONEYMAKER,
Attorney for Appellees.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

R. M. MONEYMAKER

NO. 2 2097

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Appellant,

vs.

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Appellee.

APPELLEE'S BRIEF

APPEAL FROM
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FOR THE CENTRAL DISTRICT OF CALIFORNIA

FILED

AUG 25 1967

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FOR THE NINTH CIRCUIT

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APPELLEE'S BRIEF

I

JURISDICTION

This is an appeal from an order of the United States District Court for the Central District of California, entered June 9, 1967, denying appellant's motion to vacate and set aside his sentence, judgment and indictment under the provisions of Title 28, United States Code, Section 2255.

The jurisdiction of the District Court rested on Title 18, United States Code, Sections 2113(a) and (d), and Title 28, United States Code, Section 2255.

This Court has jurisdiction to review the judgment of the District Court denying appellant's "2255 Motion", pursuant to Title 28, United States Code, Sections 1291 and 1294.

II

STATUTE INVOLVED

Title 28, United States Code, Section 2255 provides as follows:

"A prisoner in custody under sentence of a court established by Act of Congress claiming the right to be released upon the ground that the sentence was imposed in violation of the Constitution or laws of the United States, or that the Court was without jurisdiction to impose such sentence, or that the sentence was in excess of the maximum authorized by law, or is otherwise subject to collateral attack, may move the court which imposed the sentence to vacate, set aside or correct the sentence.

"A motion for such relief may be made at any time.

"Unless the motion and files and records of the case conclusively show that the prisoner is entitled to no relief, the court shall cause notice thereof to be served upon the United States Attorney, grant a prompt hearing thereon, determine the issue and make findings of fact and conclusions of law with respect thereto. If the court finds that the judgment was rendered without jurisdiction, or that the sentence imposed was not authorized by law or otherwise open to collateral attack, or that there has been such a denial or infringement of the constitutional rights of

the prisoner as to render the judgment vulnerable to collateral attack, the court shall vacate and set the judgment aside and shall discharge the prisoner or resentence him or grant a new trial or correct the sentence as may appear appropriate.

"A court may entertain and determine such motion without requiring the production of the prisoner at the hearing.

"The sentencing court shall not be required to entertain a second or successive motion for similar relief on behalf of the same prisoner.

"An appeal may be taken to the court of appeals from the order entered on the motion as from a final judgment on application for a writ of habeas corpus.

"An application for a writ of habeas corpus in behalf of a prisoner who is authorized to apply for relief by motion pursuant to this section, shall not be entertained if it appears that the applicant has failed to apply for relief, by motion, to the court which sentenced him, or that such court has denied him relief, unless it also appears that the remedy by motion is inadequate or ineffective to test the legality of his detention." (Emphasis supplied).

III

STATEMENT OF THE CASE

On May 20, 1964, a three count indictment was returned by the Grand Jury for the Southern District of California, Crim. No. 33678, [1/] charging the appellant and two other co-defendants with robbery of a National Bank with the use of a dangerous weapon and device in violation of Title 18, United States Code, Sections 2113(a) and (d).

On June 15, 1964, the appellant represented by Court appointed counsel, Mr. Morris Lavine, entered a plea of not guilty to the charges of the indictment. Between June 15, 1964 and September 1, 1964, Mr. Arthur Garrett, was substituted as retained counsel for appellant.

On September 1, 1964, the appellant withdrew his plea of not guilty to Count Three of the indictment and entered a plea of guilty to that single count. On September 20, 1964, the appellant and retained counsel, Mr. Garrett, appeared for sentencing of the appellant. On that date the Honorable Harry W. Westover sentenced the appellant to the custody of the Attorney General for a period of twenty-five years.

On May 9, 1966, the appellant filed his first "2255" motion alleging among various errors that "the plea of guilty was not

---

1/ By letter on August 9, 1967, Mr. Carl Brink, Motions Clerk, U. S. Court of Appeals for the Ninth Circuit, requested that the entire District Court file No. 33678 be forwarded to the Court of Appeals by the United States District Court.

voluntarily made but a product of sentence choice". The appellant continued by charging that his plea of guilty was the product of duress, coercion, physiological pressure, bargaining, and promise of sentence under the "new law". At no time amongst the numerous errors alleged did the appellant claim or infer that he was not competent during the proceedings [Civil No. 66-783-HW].

On May 25, 1966, the District Court, incorporating a lengthy opinion prepared in connection with a motion for rehearing in which appellant raised the same contention, denied the "2255" motion (District Court File No. 66-783-HW, ancillary to #33678 Crim. Order denying motion, and order denying Petition for Writ of Error Coram Nobis). The District Court stated, with respect to appellant's claim of certain promises made by counsel:

> "Each defendant retained counsel. Defendant Oliver first represented by appointed counsel, Morris Lavine, Esquire, engaged Arthur Garrett, Esquire. Each is a practitioner skilled in the field of criminal law. At all stages of the proceedings, one or the other of these two lawyers represented defendant Oliver. . . ."

The court continued by stating:

> "Mr. Morris Lavine is, as stated above, a veteran practitioner before all the counts - State and Federal. He has represented many, many clients charged with criminal acts. Mr. Garrett is also no

novice in the practice of criminal law.

> "What promise of leniency could Mr. Lavine or Mr. Garrett have made to a client caught at the scene of the robbery, blood dripping from a hand wounded when he resisted arresting officers with a gun?"

(District Court File No. 33677-CD ordering denying Petition for Rehearing and denying motion for modification of sentence, dated October 26, 1964.)

The District Court in its opinion also quoted portions of the appellant's signed petition to be permitted to enter a plea of guilty to Count Three of the indictment in which appellant stated:

> "[8] I declare that no officer or agent of any branch of the Government (Federal, State, or local), nor any other person, has made any promise or suggestion of any kind to me, or within my knowledge to anyone else, that I would receive a lighter sentence, or probation, or any other form of leniency, if I would plead 'guilty' . . . ." (emphasis added by District Court).

On August 2, 1966, the Court of Appeals denied leave to appeal in forma pauperis, stating:

> "The motion is denied as legally frivolous for the reasons expressed by Judge Westover in the above order." (Misc. 2858).

On September 15, 1960, appellant filed a petition for writ of certiorari which was denied on January 9, 1967.

On March 24, 1967, the appellant filed the instant "2255" motion in which he alleged:

(1) That he was mentally incompetent at the time of the alleged offense and at all times thereafter, and,

(2) That the plea of guilty was not voluntary but induced by certain promises of court appointed and retained counsel [C. T. pp. 2-15].

On June 9, 1967, the District Court denied the motion and in its order stated:

"In the current pleading he raises for the first time the assertion that he was mentally ill at the time of entering his plea of guilty. The records and files firmly and conclusively negate his contention.

"The second and remaining ground upon which he attempts to allege his sentence as invalid is that his guilty plea was involuntary and the product of intimidation and based upon a false promise that he would receive a sentence 'not to exceed (10) years.'

"This issue is res judicata by virtue of this Court's order of October 26, 1964, and the order dated May 25, 1966. . . ." [C. T. p. 20].

It is from this denial of that motion that the present appeal arises.

IV

ARGUMENT

A. THE DISTRICT COURT DID NOT ERR IN DENYING APPELLANT'S BELATED CLAIM OF MENTAL INCOMPETENCY.

The appellant after filing one Petition for Rehearing and modification of sentence, one prior "2255" motion and waiting two and one-half years after imposition of sentence raises for the first time his alleged mental incompetency to enter a plea to the charges against him.

Although a lapse of time in asserting an alleged error in a motion for post conviction relief is not controlling - it is appropriate in considering the good faith and credibility of the petitioner.

La Clair v. United States (U.S. D.C. N.D. Ind.), 241 F. Supp. 819, 824 (1965);

Rakes v. United States (U.S. D.C. W.D. Va.), 231 F. Supp. 812 (1964).

Although appellant has urged a variety of errors in prior petitions and motions in an effort to overturn his conviction, no prior claimed error has been made in any pleadings raising his mental incompetency.

Now that appellant does raise this issue he merely makes

the bold assertion that he was mentally ill and incompetent. No detailed specifications of fact are made in the petition and no probative facts are alleged in support of the general conclusionary allegation.

A careful reading of appellant's argument reflects that the import of appellant's alleged grievance is not really that he was mentally incompetent but rather that he was not sentenced under the provision of Title 18, United States Code, Section 4208(b) for a study and thereafter receive a sentence of no more than 10 years.

The appellant places great weight on the fact that three weeks after his plea of guilty was entered and at the time of sentencing, his retained attorney urged the Court to sentence the appellant for a study under Title 18, United States Code, Section 4208(b), and that when appellant addressed the court at that time he requested that he be sent some place for a psychiatric examination "because I think I need it."

This single statement made at the time of sentencing when viewed in the light of the following factors is hardly sufficient to warrant an evidentiary hearing on the claim; that the appellant at all times was represented by extremely qualified and experienced trial counsel, Mr. Morris Lavine and Mr. Arthur Garrett, who made no pretrial motion for a psychiatric examination of appellant; that appellant appeared in court on four occasions prior to entering a plea of guilty with counsel and at no time indicated to the court or apparently to counsel any factor which would raise the question of appellant's compentency to stand trial; that on June 15, 1964,

the appellant requested the court to allow him to withdraw his not guilty plea and enter a plea of guilty and again made no mention of any incapacity to enter the plea; that between the entry of the plea of guilty and time of sentence appellant was interviewed by a representative of the United States Probation office and although appellant was questioned as to his health, no mention was made by him as to any mental disability, nor was any bizzare conduct or telltale signs of mental illness reflected by the probation officer to have been observed. On the contrary, the probation report did state that "there are no indications of any emotional imbalance in the family background" (District Court File No. 33678: Probation Report].

Thus, the only evidence the District Court was left with was the unsupported statement made by appellant. Even now the appellant has failed to offer proof to support his claim such as medical records of the Bureau of Prisons, which have been relied upon in similar petitions, to give verity to the statements.

The provisions of Title 18, United States Code, Section 4208(b) are not designed as a method of determining the competency of a defendant, but rather is a post-conviction procedure to obtain "detailed information as a basis for determining the sentence to be imposed." Thus, the mere suggestion that it be utilized does not raise an issue of sanity to be determined by the court.

Therefore, in view of the foregoing the District Court did not err in finding that "the records and files firmly and conclusively negate this contention" that appellant was mentally ill at the time

of entering his plea of guilty.

B. THE DISTRICT COURT IS NOT REQUIRED TO ENTERTAIN A SECOND OR SUCCESSIVE MOTION BASED SUBSTANTIALLY ON THE SAME GROUNDS AS THE EARLIER MOTION.

Where the second or successive application under Title 28, United States Code, Section 2255, is shown conclusively on the basis of the application, files, and records of the case alone, to be without merit, the application should be denied without a hearing.

Sanders v. United States, 373 U.S. 1, 15 (1962).

The court recognized that controlling weight may be given to denial of a prior application for Section 2255 relief if (1) the same grounds presented in the subsequent application was determined adversely to the applicant on the prior application, (2) the prior determination was on the merits, and (3) the ends of justice would not be served by reaching the merits of the subsequent applications.

Sanders v. United States, supra.

1. The Same Ground Presented in the Instant Application Was Determined Adversely to Appellant in the Prior Application.

On September 21, 1964, appellant was sentenced. Shortly thereafter appellant filed a three page handwritten pleading alleging

that his plea was induced promises made by counsel Lavine and Garrett. In an eight page order filed October 26, 1964, the District Court treated the pleading as a petition for rehearing and for modification of sentence, considered, analyzed and denied appellant's claim.

On May 9, 1966, the appellant filed his first "2255" motion again alleging the identical error as urged in the earlier pleading namely, that "the plea of guilty was not voluntarily made, but a product of sentence choice; . . . . " On May 25, 1966, the District Court denied appellant's motion noting that this question had been considered by the Court in appellant's "Petition for Rehearing" as reflected by its order dated October 26, 1964.

Finally, in the instant "2255" petition the appellant again reiterates the same contention that his plea of guilty was the product of promises from counsel.

The foregoing leaves little doubt that the "grounds" for relief asserted by appellant in the instant proceedings were considered by the District Court and determined adversely to appellant.

2. The Prior Determination Was On the Merits.

The Supreme Court in Sanders, supra, at 16, in defining "adjudication on the merits", stated that a denial on the basis of the files and records "is sufficient to conclusively resolve the issue on

their merits."

The lengthy opinion and order rendered in this case denying appellant "Petition for Rehearing" dated October 26, 1964, and incorporated as part of the order denying appellant's first "2255" motion filed May 25, 1966, reflect a thorough review of the proceedings. In conclusion, the District Court stated "the record and files relating to Earl Joseph Oliver conclusively show there is no merit in the allegations . . .".

The Court of Appeals in denying appellant's petition to appeal in forma pauperis from the District Court's order dated May 25, 1966, also recognized the lack of merit in appellant's claim stating:

> "The motion is denied as legally frivolous for the reasons expressed by Judge Westover in the above order."

3. The "Ends of Justice" Would Not Be Served By Repeated Review of This Issue.

No new evidence supporting appellant's contention has been presented in the instant petition that was not available and considered by the District Court in reaching its initial decision on October 26, 1964 and again on May 25, 1966. There is no basis for relitigating an issue described as "legally frivolous" by this Court.

V

CONCLUSION

The trial court ruled correctly in denying the instant motion without a hearing upon properly finding that the files and records conclusively negate the contentions that appellant was mentally ill at the time of entry of plea, and that appellant's claim of promises by counsel had previously been determined in an earlier "2255" motion.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Robert M. Talcott

ROBERT M. TALCOTT

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NO. 22099

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN ANTONIO DA COSTA,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

I

JURISDICTIONAL STATEMENT

This is an appeal from the judgment of the United States District Court for the Southern District of California, adjudging appellant to be guilty as charged in one count of a two-count indictment, at the conclusion of trial by jury.

The offense occurred in the Southern District of California. The District Court had jurisdiction by virtue of Title 18, United States Code, Sections 1407 and 3231. Jurisdiction of this Court rests pursuant to Title 28, United States Code, Sections 1291 and 1294.

II

STATEMENT OF THE CASE

Appellant was charged in a two-count indictment returned by the Federal Grand Jury for the Southern District of California. [C.T. 2-3].[1/]

Count One charged that appellant left the United States within the Southern Division of the Southern District of California without registering with a Customs official, agent, or employee as required by law and without obtaining the certificate required by law to be obtained upon leaving the United States, being a citizen of the United States who was convicted of conspiracy to smuggle, acquire, and receive marihuana in 1953 and sale, etc., of heroin in 1956. [C.T. 2].

Count Two charged that appellant returned to, and entered into, the United States within the Southern Division of the Southern District of California without registering and without surrendering, to a Customs official, agent, or employee, the certificate which should have been obtained prior to departing from the United States, as required by 18 U.S.C.A. 1407 and certain rules and regulations, being a citizen of the United States who had the prior marihuana and heroin convictions mentioned in Count One. [C.T. 2-3].

Jury trial of appellant commenced on July 19, 1966, before United States District Judge Fred Kunzel [R.T. 4].[2/] The Court granted appellant's motion for judgment of acquittal as to Count One [R.T. 192]. Appellant

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1/ "C.T." refers to the Clerk's Transcript of Record.

2/ "R.T." refers to the Reporter's Transcript on Appeal.

was found guilty as charged in Count Two on July 21, 1966 [C.T. 4].

Thereafter, on September 19, 1966, appellant was given a suspended sentence of three years with probation for five years [C.T. 5]. He filed a timely notice of appeal [C.T. 6-7].

III

ERROR SPECIFIED

Appellant specifies the following points upon appeal:

1. Alleged insufficiency of the evidence to sustain the verdict.
2. Alleged error in instructing the jurors to acquit appellant if they believed part of his testimony.
3. Alleged error in instructing the jurors in regard to the "uses" provision of 18 U. S. C. A. 1407.
4. Alleged unconstitutionality of 18 U. S. C. A. 1407.

(Appellant's Opening Brief, p. 21).

IV

STATEMENT OF THE FACTS

Appellant was seen in Inglewood, California, by United States Customs Agent Thaine Ellis on July 24, 1964 [R.T. 10-11]. He was seen at the police headquarters in San Luis, Mexico on the afternoon of June 12, 1965 [R.T. 13-15]. He was seen by United States Customs Agent Donald Quick near the Roadside Inn at Jacumba, California, on the same night between midnight and 12:30 [R.T. 23, 58-61].

Evidence was received relating to appellant's citizenship (place of birth) and prior convictions of conspiracy to smuggle, etc., marihuana

in 1953 and sale, etc., of heroin in 1956 [R.T. 8-9, 278-80].

A search of Customs records showed no indication that appellant registered under 18 U. S. C. A. 1407 at any Mexican-American border-crossing station in California or Arizona during June of 1965 [R.T. 26, 33-36, 40-43]. Appellant testified that he did not register upon the occasion in question and that he entered the United States at San Luis, Arizona [R.T. 194-95, 212]. He testified that he knew that he was required to register and that he also failed to register upon leaving the United States [R.T. 212]. He had previously registered with Customs twice in July, 1964; once in October, 1964; twice in November, 1964; once in December. 1964; and once in March, 1965 [R.T. 185-86, 189-90].

On June 10, 1965, United States Customs Agent George F.Holleron had placed a "lookout" for appellant at the port of entry at San Luis, Arizona [R.T. 150-51]. A "lookout" consisted of a description of a person or automobile. This particular lookout contained a photograph of appellant, placed upon a board at the pedestrian traffic lane in the vicinity of the inspector on duty. Agent Holleron instructed the inspectors on duty to detain and search appellant [R.T. 152-53, 158]. Agent Holleron received no later reports to the effect that appellant had been stopped and searched at the San Luis port [R.T. 160-61]. Upon some occasions in the past, persons upon "lookout" had been overlooked by inspectors at San Luis [R.T. 162].

Customs Inspector John O. Ford was on duty at San Luis from 4 p.m. until midnight on June 12, 1965, and was aware of the "lookout" for appellant. Only one other inspector was on duty during that shift, and

Inspector Ford discussed the "lookout" with him. Agent Holleron gave Inspector Ford some vehicle license numbers in connection with that "lookout" on June 12. Inspector Ford did not observe an entry by appellant at the San Luis port of entry and received no information that he had entered [R.T. 163-65, 167].

San Luis is 24 miles south of Yuma and about 60 miles east of Calexico. San Luis, Mexico, is on the Mexico-Arizona border about 12 miles from the State of California [R.T. 15, 20]. Jacumba, California, is on the Mexican-American border, about 50 miles from Calexico. Highway 80 passes through Jacumba at a point about three-eighths of a mile north of the border. The Roadside Inn also was about three-eighths of a mile from the border [R.T. 60, 63, 65]. There was a barbed wire fence at the border at Jacumba [R.T. 67].

The shortest route by standard roadways between San Luis and Jacumba was through Mexico and Calexico. This also was the fastest San Luis-Jacumba route in the daytime, although the Yuma route was better at night, because the American highway was better. The Mexican route to Calexico was partially under construction at that time [R.T. 78-80, 90-91, 95, 133].

The distance from San Luis, Arizona, to Jacumba was approximately 137 miles by the American route (through Yuma) and approximately 106 miles by the Mexicali route (through Calexico) [R.T. 138-39]. The normal traffic delay at Calexico would not be more than 5 or 10 minutes at the most [R.T. 142]. Appellant testified that Elaine Bryant, one of his companions

in San Luis, Mexico, on June 12, was driving a blue 1965 Mustang automobile. He testified that he made arrangements at San Luis, Mexico, to meet Miss Bryant at the Roadside Inn in Jacumba [R.T. 195-96, 198]. At approximately 11 p.m. on June 12, 1965, a blue 1965 Mustang automobile arrived at the port of entry at Calexico with only one occupant, a female. The Mustang vehicle was on "lookout" at Calexico, was searched, and then proceeded into the United States [R.T. 58-60, 146]. Customs Agent Paul Martin followed the vehicle from Calexico to Jacumba, Elaine Bryant was the driver of the Mustang. Customs Agent Quick saw appellant talking with "Alene Marie Bryant" at the Roadside Inn [R.T. 61, 172-73, 181].

Appellant testified that he left the police office at San Luis, Mexico, at approximately 7:30 on June 12; rode to the border in a white Rambler; and walked across the border at San Luis, Arizona, answering the questions asked by the Customs Inspector [R.T. 194-99]. He testified that he was wearing a sombrero-type hat, that he kept his head down, and that he looked at the inspector over the top rims of his glasses and under the brim of his hat [R.T. 194-95, 199]. He testified that he then entered the Rambler, which had been driven across by a friend. He declined to name the friend. However, when the Court ordered an answer, he admitted that the friend was Richard Cook [R.T. 199-199-A].

Appellant testified that he rode in the car to Jacumba, arriving between 11 and 12, closer to 12; that Erline was not there; that Cook left in the Rambler; that he saw Cook again that night in Pasadena; and that he, appellant, was with Erline Bryant and one other man at the Roadside Inn.

[R.T. 200-202].

Appellant also testified that one Rodriguez, a friend of his, was at the Roadside Inn but was not with appellant; that he did not speak to Rodriguez; that he went from Jacumba to San Diego and went by Rodriguez's house because "I figured that's where he would go"; and that Rodriguez was with him when the vehicle was subsequently stopped and partially searched at the San Clemente immigration checkpoint on the route from San Diego to Pasadena [R.T. 204, 208-10].

Customs Port Investigator Owen Miller, Jr., testified that he saw Miss Bryant and three other persons, including appellant, at a cafe in Jacumba, and that they appeared to be talking [R.T. 68, 70, 74, 76]. Appellant testified that he was with Erline and only one other man at the Roadside Inn [R.T. 202]. Appellant admitted two felony convictions [R.T. 214].

V

ARGUMENT

A. THE EVIDENCE WAS SUFFICIENT TO SUSTAIN THE CONVICTION.

Appellant asserts that the evidence was insufficient to sustain the conviction He does not contend that the Government failed to prove any of the elements of the crime. On the contrary, he admits that he entered the United States without registering. [R.T. 212].

To summarize appellant's position, he does not deny that he

committed the crime but claims that he was tried and placed upon probation in the wrong District. This is simply a venue objection which appellant describes as a question of "jurisdiction and venue . . . ." (Appellant's Opening Brief, p. 22). However, this is not a jurisdictional question, since there is no doubt that the Court had jurisdiction of the defendant and jurisdiction to hear prosecutions under 18 U. S. C. A. 1407.

The terms "jurisdiction" and "venue" should not be confused.

Farmers Elevator Mut. Ins. Co. v. Carl J. Austad & Sons, Inc. 343 F.2d 7, 11 (8th Cir. 1965);

Toulmin v. James Mfg. Co., 27 Fed. Supp. 512, 515 (W.D.N.Y. 1939).

Venue may be waived. The term, "venue," "'does not refer to jurisdiction at all.'"

Arganbright v. Good, 46 Cal. App. 2nd Supp. 877, 878-79, citing Paige v. Sinclair, 130 N. E. 177, 178.

A venue question is not a question of jurisdiction.

Lii v. United States, 198 F. 2d 109, 113 (9th Cir. 1952).

Treating the question as one of venue, it is apparent that appellant waived his venue objection by going to trial upon the merits.

Rodd v. United States, 165 F.2d 54, 56 (9th Cir. 1947), cert. denied, 334 U. S. 815 (1948).

Venue objections may not be considered upon appeal where, as here, there was no motion for change of venue in the trial court.

Carbo v. United States, 314 F.2d 718, 733, n.15 (9th Cir. 1963).

Appellant made no such motion, possibly preferring a trial in a District closer to his own residence.

However, assuming arguendo that appellant has not waived his venue objection, it is respectfully submitted that a consideration of the evidence most favorable to the prevailing party in the trial court, which is the proper test upon appeal, [3/] leads to the conclusion that venue was proved beyond a reasonable doubt, even though the Government was not required to prove venue beyond a reasonable doubt.

The reasonable doubt rule does not apply to proof of venue.

Hill v. United States, 284 F.2d 754, 755 (9th Cir. 1960), cert. denied, 365 U.S. 873 (1961).

United States v. Charlton, 372 F.2d 663, 665 (6th Cir. 1967), cert. denied, 387 U. S. 936 (1967).

Dean v. United States, 246 F.2d 335, 338 (8th Cir. 1957);

Blair v. United States, 32 F.2d 130, 132 (8th Cir. 1929).

> "If there were any error it favored defendants because the court's instruction may have required the jury to find venue beyond a reasonable doubt, and by the great weight of authority, venue is a fact which need be proved only by a preponderance of the evidence."

Charlton, supra, at p. 665.

3/ Davenport v. United States, 260 F.2d 591, 598 (9th Cir. 1958), cert. denied, 359 U.S. 909 (1959).

It is apparent that venue may be established by circumstantial evidence, as it has been held that "If, upon the whole evidence, it may reasonably be inferred that the crime was committed where the venue was laid, that is sufficient."

United States v. Chiarelli, 192 F.2d 528, 532 (7th Cir. 1951), cert. denied, 342 U. S. 913 (1952) (Emphasis added).

It was clear from the evidence that appellant entered the United States without registering. The venue question, if such a question remains to be decided, involves the determination of whether the entry was at San Luis, Arizona, as claimed by appellant, or along the Mexico-California border, as determined by the unanimous jury verdict.

Appellant was in San Luis, Mexico, on the afternoon of June 12, 1965. On the same night, between midnight and 12:30, appellant was observed at Jacumba, California, at a point approximately three-eighths of a mile north of the border between Mexico and California (i.e., the Southern District of California) [R.T. 13-15, 58-61, 63, 65].

The shortest route by standard roadways between San Luis and Jacumba was through Mexico (i.e., to the Mexico-California border) [R.T. 79-80]. Appellant claimed to have crossed the border at San Luis, Arizona, but there was a "lookout" for him with his photograph at the San Luis port of entry, both inspectors at that port were aware of the "lookout," and one of them, Inspector Ford, did not observe any entry by appellant and received no information that he had entered, although the "lookout" called for search of appellant [R.T. 150-52, 158, 163-65, 167, 194-95].

Appellant contended that Elaine Bryant, one of his companions in Mexico, had agreed to meet him in Jacumba [R.T. 195-96, 198]. Miss Bryant entered the United States at Calexico, California. She arrived at Jacumba between 12 and 12:30 [R.T. 23, 58, 61]. Appellant testified that he arrived at Jacumba between 11 and 12, closer to 12 [R.T. 200]. It is unlikely that they would have reached this alleged rendevous point so close in time with one party going through Mexico to California and the other party going through Arizona to California. It is even more unlikely that the leaders of this team would send one vehicle on the Mexican side and another on the American side, to arrive at the same destination. They may have preferred the Calexico route because it was shorter or the American route because the roads were better, but they would not prefer both routes.

In view of appellant's two prior felony convictions, his impeachment upon the question of the number of companions present at Jacumba, his evasiveness when questioned concerning the activities of Richard Cook, and his unbelievable account of the role of Rodriguez, it is respectfully submitted that the jurors were fully justified in rejecting appellant's claim that he talked to the inspector at San Luis and proceeded through the port of entry after peering at the inspector over the top of his glasses, under the brim of a sombrero-type hat [R.T. 70, 74, 76, 194-95, 199, 199-A, 202, 204, 207-10, 214].

> "It was for the jury to determine where the truth lay. They were not required to believe the appellant."
>
> Davenport v. United States, 260 F.2d 591, 598 (9th Cir. 1958)

Appellant quotes a statement by the prosecutor to the effect that the case was "thin" and a suggestion by the trial Judge to the effect that the case was not strong. [R.T. 96]. However, they were not discussing the total case now before this Court. Following these remarks, nearly 95 additional pages of testimony appear in the record before the point at which the Government rested its case [R.T. 96-191]. This includes the damaging testimony regarding the "lookout" at San Luis [R.T. 151-161].

Appellant finds fault with the trial Judge's suggestion that appellant might have avoided the San Luis port of entry in order to avoid Federal agents who might be looking for him. Appellant states that he had no reason to suspect re-arrest after release by Federal agents in Mexico (Appellant's Opening Brief, pp. 24-25). However, there was no evidence that appellant was released by American Federal agents in Mexico. He was released by municipal police [R.T. 196]. Although a Yuma County Deputy Sheriff spent some time with appellant on that occasion, the deputy pretended to be an officer from Sonora [R.T. 12-13, 15, 19], so appellant had no reason to believe that he was released by American authorities.

Appellant states that there was a "lookout" for him at Calexico (Appellant's Opening Brief, p. 25). Appellee has been unable to find such evidence in the record. Appellant's counsel told the jury that there was a lookout at San Luis and that "There was no showing that they placed a lookout any place else." [R.T. 249].

Of course, the existence of a "lookout" at Calexico would not in any way obstruct appellant from slipping under, through, or over the barbed

wire at the border at Jacumba.

B. THE INSTRUCTION TO ACQUIT APPELLANT IF THE JURORS BELIEVED PART OF HIS TESTIMONY DID NOT CONSTITUTE ERROR.

The trial Judge instructed the jurors as follows:

"If you believe the defendant, believe that he crossed at San Luis that evening of June 12th, as he stated, you must then acquit him." [R.T. 283]. This was an instruction in appellant's favor. It amounted to an additional warning to the jurors that lack of venue was a defense even though appellant had, as a practical matter, confessed to commission of the alleged crime in another District. Nevertheless, appellant now objects to this instruction, although there was no objection in the trial Court. [R.T. 218, 288-89].

Appellant also objects to other instructions concerning inferences which could be drawn from the evidence.[4/] The trial Judge summed up the matter by telling the jurors:

"As I say, there is the direct evidence which you can judge

4/ These instructions related to the question of venue, which was waived by failure to move for change of venue. If appellant contends that the question is one of jurisdiction, rather than venue, the instructions were not prejudicial, as jurisdictional questions are decided by the Court, not the jury. 23A C.J.S., p. 274.

and weigh, that the entry was in Arizona; and there is circumstantial evidence from which certain inference can be drawn if you believe the inference should be drawn." [R.T. 285].

This does not indicate that the trial Judge favored one side in the case. Furthermore, he instructed the jurors that "you are the sole judges of the facts," [R.T. 272]; "As I told you a moment ago, you, in addition to being the sole judges of the facts, are also the sole judges of the credibility of the witnesses and the weight their testimony deserves" [R.T. 276]; "you are the sole judges of the facts . . . you may disregard any comment that I might make concerning the evidence in this case" [R.T. 282]; "you may disregard any comments I make upon the evidence" [R.T. 285]; and "Remeber at all times that you are the jurors and you are at liberty to disregard any comments that I have made in arriving at your findings as to the facts." [R.T. 285].

It is presumed that jurors follow the instructions of the court. Cook v. United States, 354 F.2d 529, 532 (9th Cir. 1965).

Aside from the innocuous matter of the Court's comment upon possibilities of a "lookout" at Calexico, appellant failed to object to any of the instructions which he now finds unacceptable [R.T. 217-222, 288-89]. Consequently, appellant's objections to the instructions are barred by Rule 30 of the Federal Rules of Criminal Procedure, which provides in part as follows:

"No party may assign as error any portion of the charge or omission therefrom unless he objects thereto before the

jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection."

In view of the mildness of the instructions in question, this case does not appear to be a proper one for disregarding Rule 30 with "this shotgun, 'plain error.'" 5/

C. THE READING OF PORTIONS OF 18 U.S.C.A. 1407 DID NOT CONSTITUTE ERROR.

Appellant was charged under Title 18, United States Code, Section 1407. During the instructions to the jury, the trial Judge read part of this statute, including portions stating that the law applies to narcotics addicts, users, and certain prior convicted violators [R.T. 280-81].

Appellant, having made no objection to the reading of portions of the statute during the trial, 6/ now finds fault with the instruction upon the ground that it is impossible to determine whether the jurors found him to be an addict, user, or prior convicted violator. There is no problem here. There was no evidence of addiction or use, there was evidence of prior convictions, and the only real issue in the entire trial was the question of venue.

5/ Judge Chambers concurring and dissenting opinion in Herzog v. United States, 235 F.2d 664, 673 (9th Cir. 1956).

6/ Appellant's counsel was informed in advance that the statute would be read to the jury [R.T. 218].

D. 18 U. S. C. A. 1407 VIOLATES NEITHER THE FIFTH NOR EIGHTH AMENDMENT.

During the trial appellant contended that 18 U.S.C.A. 1407 was unconstitutional, without specifying the portions of the Constitution which allegedly were violated, except for a reference to the self-incrimination privilege [R.T. 57-58, 220]. He now states that the statute violates the right to travel and constitutes cruel and unusual punishment.

The statute imposes a slight requirement upon the international traveler, somewhat less than the well-known smallpox vaccination requirement which has been imposed upon millions of citizens who have no prior narcotics records.

The mere requirement of filling out and handing over a registration certificate does not constitute a violation of the right to travel.

Reyes v. United States, 258 F.2d 774, 782-83 (footnote).

"'The right to travel is not an absolute one, free of all restraint or regulation.'"

Reyes, supra, at p. 783 (footnote).

Since registration is not a "punishment," the statute does not involve cruel and unusual punishment.

VI

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the Court below should be affirmed.

Respectfully submitted,

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Attorneys for Appellee,
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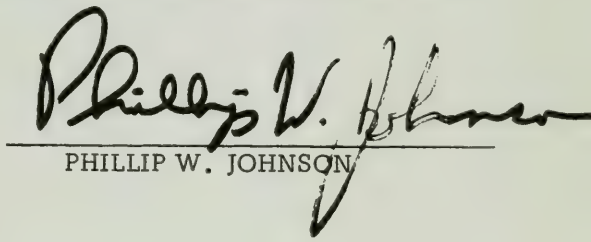
CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.



PHILLIP W. JOHNSON

No. 22,102

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HARRY SUGARMAN,

Appellant,

vs.

JACK B. FORBRAGD, et al.,

Appellee.

APPELLANT'S OPENING BRIEF

Appeal to Review Judgment of the
United States District Court for
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IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HARRY SUGARMAN, *Appellant,* vs. JACK B. FORBRAGD, et al., *Appellee.*	]	No. 22,102

APPELLANT'S OPENING BRIEF

BRIEF FOR PETITIONER

This case is before the Court on appeal to review judgment of the United States District Court for the Northern District of California.

OPINION BELOW

The memorandum opinion of the United States District Court (IR. 98-124) is reported at 267 F. Supp. 817 (1967).

JURISDICTION

This is an interlocutory appeal from an order entered on May 16, 1967, by the United States District Court for the Northern District of California, dismissing Harry Sugarman's petition for a Writ of Mandatory Injunction (IR. 125-126). The underlying action was brought by the petitioner to compel

the Food and Drug Officers to allow reconditioned coffee beans to be used in the production of blended coffee in the United States under the authority of Section 10 of the *Administrative Procedure Act*, specifically 5 U.S.C. 701(e) (formerly 1009(e)). The district court's jurisdiction was invoked under 28 U.S.C. 1361 (IR. 1-7 including Pet. Exh. "A"-"O"). The petitioner, on June 30, 1967, filed in the district court a timely Notice of Appeal under 28 U.S.C. 2107 (IR. 127). This Court's jurisdiction accordingly rests upon 28 U.S.C. 1291.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the *Administrative Procedure Act* (60 Stat 243 (1946)) as amended, 5 U.S.C. §§552-558, 701-706; §§801, 701 and 304(d) of the *Federal Food, Drug and Cosmetic Act* (52 Stat. 1050, 1055 (1938) as amended; 21 U.S.C. 381, 371, 334(d); and §§ 1.318-1.320, and 4.1(c) of the *Regulations for the Enforcement of the Federal Food, Drug and Cosmetic Act* (20 F.R. 9539, 9554 (1955) as amended), and 21 C.F.R. §§ 1.318-1.320, 4.1(c) are set forth in the Appendix to this Brief.

QUESTIONS PRESENTED

1. Whether governmental determinations on the admissibility of imports are subject to judicial review, either by trial de novo or under the Administrative Procedure Act.

2. Whether governmental hearings on the admissibility of imports are subject to the uniform procedures

expressed in the Administrative Procedure Act.

3. Whether genuine and triable issues of material fact exist, as evidenced by opposing documents submitted in the District Court, which relate to the fitness as food of 3,394 sacks of coffee beans.

STATEMENT

PROCEEDINGS BELOW

This is a suit brought by the petitioner to compel the Food and Drug Officers to allow the import of reconditioned coffee beans so that they may be sold in the United States for the production of blended coffee. The petitioner seeks a decision based upon the exclusive record of an administrative hearing under the authority of §801 of the *Federal Food, Drug and Cosmetic Act,* 21 U.S.C. 381 and §7 of the *Administrative Procedure Act,* 5 U.S.C. 556(e), formerly 1006(d).

The following is a brief account of the background of this case.

The coffee beans in question were being transported from Colombia to Japan in March 1966, when a fire occurred aboard ship. They were watered down with fresh and salt water and unloaded at the distress port of Los Angeles, California. Purchased by the petitioner, the coffee beans were then transported to Turlock, California, where they were cleaned, dried and resacked under the supervision of the U. S. Customs. On July 20, 1966, the petitioner filed for consumption entry at

the Bureau of Customs, San Francisco, offering for import 3,394 sacks of reconditioned coffee beans.

On July 21, 1966, Food and Drug Officer Fred E. Norman issued a Notice of Detention and Hearing (Pet. Exh. A) on the contention that the reconditioned coffee beans were adulterated within the meaning of Section 402(a)(3).

Commencing on August 18, 1966, the petitioner attempted to secure from the FDA the scientific basis for the detention of the coffee beans. The requested information was not provided. (See Pet. Exh. A-1). The petitioner's attorney, after consulting with scientific advisors, felt impelled to continue to press for specific scientific data essential to preparing for a meaningful administrative hearing on the detained coffee beans. However, late in November, the Food and Drug Administration severed further discovery procedures and scheduled the administrative hearing. (Pet. Exh. G-1).

On January 6, 1967, a hearing was held in San Francisco, California, before Food and Drug Hearing Officer Fred E. Norman at which the petitioner appeared and introduced evidence. The FDA refused to offer any evidence at all. The hearing was completed, and the matter was submitted for decision. (Pet. Exh. I-1 and J).

On February 1, 1967, Food and Drug Officer Jack B. Forbragd approved only part of the petitioner's application, allowing said coffee beans to enter the United States to be used in the production of soluble coffee but not in the production of blended coffee. (Pet. Exh. K and L).

On February 15, 1967, the petitioner submitted his application asking reconsideration on the matter of using the said coffee beans in the production of blended coffee. On March 28, 1967, Mr. Forbragd notified petitioner's attorney by telephone and by letter that the latter application was denied. (Pet. Exh. M-O and Def. Exh. IG).

On March 31, 1967, a petition for Writ of Mandatory Injunction to compel the Food and Drug Officers to approve petitioner's application to allow the reconditioned coffee beans to be used in the production of blended coffee in the United States was filed. (IR. 1-10).

On April 19, 1967, the government filed a motion for dismissal of the petition for summary judgment. (IR. 23-88).

On April 20, 1967, petitioner filed a cross-motion for summary judgment. (IR. 14-22).

On May 2, 1967, the District Court heard the petition and motions, (Reporter's Transcript (IIR.)), and on May 16, 1967, the District Court Order was entered dismissing the petition and denying petitioner's said motion and granting the government's motion for summary judgment. (IR. 125).

EFFECT OF THE DECISION BELOW

The specific question of the present action is whether 3,394 sacks of coffee beans should be admitted to the United States. The underlying question, the fundamental issue, is the proper *modus operandi* of a government agency. The appellant respectfully calls to the attention of the present court

the implications of the lower court's decision. The District Court has said in effect that a governmental agency can make import determinations which can have adverse effects--sometimes drastic--on an individual citizen, without basic safeguards:

1) The FDA is *not* required to inform individuals fully as to the basis of its action;
2) The FDA is *not* required to conduct a fair hearing in which both sides state for the record their arguments;
3) The FDA is *not* required to submit the record of a case for judicial review at the behest of an adversely affected individual.

SUMMARY OF ARGUMENT

Basing its arguments upon a particular wording within the Food, Drug and Cosmetic Act composed sixty years ago, the Food and Drug Agency claims that its actions regarding exclusion of imports are unchallengeable because it possesses absolute discretion. The appellant maintains that the intent of Congress, as demonstrated within the Food, Drug and Cosmetic Act, within the Administrative Procedure Act, and by the legislative histories of both acts, was to grant no such power to the FDA. Moreover, the courts actually have reviewed import determinations, creating a precedent strengthened by the passage of the Administrative Procedure Act. Since the passage of this reform act, both the courts and recognized authorities have stated forcefully and specifically that the

safeguards of the APA should be energetically applied regarding FDA regulatory actions. Thus, providing for judicial review and for fair hearings is fundamentally in accord not only with our general legal traditions, but also with contemporary judicial and legislative actions.

Nonetheless, such provision has not clearly been maintained regarding import adjudication procedures. Thus this case inevitably will have far-reaching effects; all industries involved with the importing of food, drugs or cosmetics will be touched by its outcome. It provides an opportunity for extending the uniform procedures governing other administrative activity to cover import adjudications, so that the interests of all--the import industry, the public and the FDA itself--may be upheld. The court will avail itself of this opportunity by reaffirming the precedent for judicial review of import adjudications and by reversing the decision of the lower court.

The District Court's issuance of a summary judgment in the present case confounded the intent of the APA. But even if the APA had not existed, the District Court would still have been in error in granting a summary judgment to the governement because there did exist triable issues of fact. Thus, the appellant respectfully petitions the court to remand the case to the District Court with instructions that provision now be made for a fair hearing or that a trial *de novo* be conducted.

ARGUMENT

I

THE FDA IMPORT DETERMINATION PRESENTLY IN QUESTION IS REVIEWABLE

A. Administrative Procedure Act Was Passed by Congress to Insure Adequate Court Remedy for Individuals.

The making of adjudications is the exercise of authority by an administrative agency wherein the agency acts essentailly as a court, handing down decisions involving the individual parties. Adjudications are the principal method whereby the agency applies the law enacted by Congress to private persons. They involve such matters as granting or withholding licenses, determining law violations, setting individual rates and determining the admissibility of imports.

It is obvious that determinations resulting from the adjudication process can have far-reaching effects on private citizens. Cognizant of this fact, Congress saw fit to pass the Federal Administrative Procedure Act in 1946. Its major objective was to protect individuals from arbitrary actions by government officials. Thus, the act provided that concerned individuals have reasonable access to government information, that hearings be conducted fairly, and that there be provision for judicial review of agency decisions. Upon a showing that an agency was exceeding its jurisdiction, prompt judicial intervention was mandated. The aim in providing these individual protections was not to hamper the workings of any agency; rather it was felt that the passage of the APA would

improve the operation of government agencies by eliciting better administrative decisions.

Two APA provisions clearly proclaiming Congress' intent that judicial review be readily accessible are as follows:

§702, entitled, "Right of Review," says:

> "A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof."

§704, entitled, "Actions Reviewable," states:

> "Agency action made reviewable by statute and *final agency action for which there is no other adequate remedy in a court are subject to judicial review.*" (Emphasis added.)

B. The Supreme Court Has This Year Ruled That APA Review Provisions Apply to FDA Actions.

In 1956, in *Brownell vs. Wo Shung*, 352 U.S. 180, 185, the Supreme Court stated:

> "...'exemptions from the...Administrative Procedure Act are not lightly to be presumed' and unless made by clear language of supersedure the expanded mode of review granted by the Act cannot be modified."

Now in 1967, the highest court of the land has gone on to apply specifically the review sections of the APA to actions of the Food and Drug Administration. In the *Abbott Laboratories vs. Gardner*, (1967) 387 U.S. 136 and *Toilet Goods Association, Inc. vs. Gardner*, (1967) 387 U.S. 158 decisions, handed down since the decision of the District Court in the present case, it was held that the FDA must follow APA procedures in promulgating regulations. Regarding court sur-

veillance, the court stated:

> "...survey of our cases shows that judicial review of a final agency action by an aggrieved person will not be cut off unless there is persuasive reason to believe that such was the purpose of Congress. (Citations)
>
> "Early cases in which this type of judicial review was entertained have been reinforced by the enactment of the Administrative Procedure Act, which embodies the basic presumption of judicial review to one 'suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute,' 5 U.S.C. 702, so long as no statute precludes such relief or the action is not one committed by law to agency discretion, 5 U.S.C. 701(a). The Administrative Procedure Act provides specifically not only for review of 'Agency action made reviewable by statute' but also for review of 'final agency action for which there is no other adequate remedy in a court,' 5 U.S.C. 704. The legislative material elucidating that seminal act manifests a congressional intention that it cover a broad spectrum of administrative actions, and this Court has echoed that theme by noting that the Administrative Procedure Act's 'generous review provisions' must be given a 'hospitable' interpretation. (Citations) Again in *Rusk vs. Cort*, supra, at 370-380, the Court held that only upon a showing of 'clear and convincing evidence' of a contrary legislative intent should the courts restrict access to judicial review. See also Jaffe, Judicial Control of Administrative Action 330-359 (1965)."

Abbott Laboratories vs. Gardner, supra, at 140-141.

The appellant maintains that the determination in question fits easily within the "broad spectrum of administrative actions" that Congress intended be covered by the APA's "generous review provisions." He believes he can demonstrate not only a lack of "'clear and convincing evidence' of a contrary legislative intent" but also positive indications that

Congress did envisage Court protection for individuals in situations comparable to the present.

C. The District Court Erred in Applying The Second Exception of APA 701(a) to The Present Case.

APA Section 701(a) specifies just how broadly the Act's provisions on judicial review are to be applied. It states:

> "This chapter applies, according to the provisions thereof, except to the extent that--
>
> (1) statutes preclude judicial review; or
>
> (2) agency action is committed to agency discretion by law."

The fact that the Food, Drug and Cosmetic Act does not expressly preclude judicial review of import determinations is obvious enough; it is not even contested by the District Court. Instead, the Court relies on the second exemption of APA 701(a) and argues that judicial review is precluded in this case because FDA's actions were "committed to agency discretion by law." An examination of the Food, Drug and Cosmetic Act serves to refute this argument.

1. Internal evidence from the Food, Drug and Cosmetic Act indicates that the FDA lacks absolute discretion regarding import adjudictions.

a. FDA lacks absolute discretion when judging domestic products; criteria for judging imports are the same.

While not denying that FDA does indeed have a burden of proof in domestic seizures, the Court bases its contention that safeguards to the individual do not apply regarding

imports on the argument that the legislature in writing a separate FD&C Act section in imports decreed a totally different procedure for them. Because the separate section 801 states:

> "If it appears from the examination of such samples or otherwise that...such article is adulterated...then such article shall be refused admission..."

The District Court claims that the FDA can make an unchallengeable determination of the fitness of any import product, solely on the basis of its estimation of that product's appearance.

The fact is that Congress did not relegate its instructions regarding the agency's handling of imports to 801. Imports are mentioned all through the Act, and many times it is specified or implied that they are to be treated similarly to domestic products. For example, §304(d)(1) governing seizure actions makes no distinction regarding criteria for judging fitness between food of domestic origin and food imported into the United States. The FDA itself underlined this statement when it chose to cite §402(a)(3), undeniable criterion for domestic products, to condemn the appellant's import product. (See Pet. Exh. A). Inasmuch as criteria for judging food offered for import is the same as that for domestic food, what then, it may be asked, is the purpose of §801? The logical purpose for including §801 is that the District Court could not otherwise obtain jurisdiction over a product offered for import since the product would be outside the United States. The seizure procedure would not be

applicable. There is no evidence that Congress, in making said exclusion procedure applicable by adding §801, intended that the determination procedure be different from that employed in domestic seizures.

b. The FDA lacks absolute discretion when promulgating regulations; logic dictates that if regulations are reviewable, that determinations also be reviewable.

The *Abbott Laboratories* case dealt with §701 of the FDC Act which describes procedures for issuing regulations. §701 clearly covers regulations made relative to the import provisions of §801, and there is no question but that judicial review is guaranteed regarding issuance of import rules. There is no basis for distinction between judicial review of regulations under §801 and of determinations made pursuant to that same section. To hold otherwise would produce absurd consequences and could give vent to the very evil which the APA sought to correct. If it were held that an individual were entitled to judicial review of regulations but not of determinations, then it can be foreseen that the agency could arbitrarily choose to promulgate only a minimal number of regulations, thereby freeing itself of obligation to follow APA procedures. The agency could exercise authority by means of determinations, none of which could come under the scrutiny of the courts. Surely such would defeat the very purpose for which the APA was enacted. Furthermore, considering the inflexibility and definitive nature of regulations as opposed

to the degree of variability of opinion with which determinations are made, common sense decrees that if judicial review is required at all that requirement for determinations should take precedence over that for regulations.

That language of §701 of the FDC Act implies that import adjudications are subject to review.

An underlying assumption that the FDA would in no instance be entirely immune from judicial surveillance manifests itself a number of times within §701. For example, §701(f)(6) states:

> "The remedies provided for in this subsection shall be in addition to and not in substitution for any other remedies provided by law."

§701(g) states:

> "A certified copy of the transcript of the record and proceedings under subsection (e) (procedure for holding hearings on proposed regulations) shall be furnished by the Secretary to any interested party at his request, and payment of the costs thereof, and shall be admissible in any criminal libel for condemnation, *exclusion of imports, or other proceedings arising under or in respect of this Act,* irrespective of whether proceedings with respect to the order have previously been instituted or become final under subsection (f)." (Emphasis and explanation added.)

If hearing transcripts in any "proceedings arising under... this Act," including those regarding exclusion of imports, "shall be admissible," then the implication is certainly that Congress does not preclude the possibility that import adjudications will be reviewed.

2. Analysis of the second exception by recognized authorities supports applicability of judicial review in the present case.

As stated by the Ninth Circuit in *Ferry vs. Udall*, (1964) 336 F.2d 706 at 711, the problem of interpreting APA Section 701(a) "is that of determining when the agency action is 'committed to agency discretion' and when it merely 'involves' discretion which is nevertheless reviewable. 4 Davis, Administrative Law Treatise 28.16 pp. 80-81; Anno:, Administrative Procedure Act, 97 L. Ed. 884, 889."

The authority referred to Professor K. C. Davis, University of Minnesota Law School, has this to say on the subject:[1]

> "A practical interpretation which will carry out the probable intent and which will produce sound substantive results will emphasize the word 'committed' to agency discretion, it is not reviewable, even for arbitrariness, or abuse of discretion; it is not 'committed' to agency discretion to the extent that it is reviewable. The two concepts 'committed' and 'unreviewable' have in this limited context the same meaning. Both depend upon what is committed 'by law' to agency discretion--*both depend upon the statutes and the common law.* To the extent that 'the law' cuts off review for abuse of discretion, the action is committed to agency discretion. The result is that the pre-Act law on this point continues. And the courts remain free, except to the extent that other statutes are controlling, to continue to determine on practical grounds in particular cases to what extent action should or should not be unreviewable even for abuse of discretion." (Emphasis added.)

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[1] Davis, Administrative Law Treatise, 1965 Pocket Part Sections 28.16, pages 15-30 at 21.

Davis' analysis supports the appellant's contention that the FDA's determination under the FDC Act, Section 801, wa not an agency action "committed by law to agency discretion." Davis says reviewability depends upon common law which traditionally *has* afforded judicial review, in regard to Section 801 by virtue of *Ambruster vs. Mellon,* (D.C. Cir. 1930) 41 F. 2d 430 and the *The James J. Hill* (D. Md. 1946) 65 F. Supp. 265. In light of the fact that there is no substantial difference between the present case and the *Ambruster* and *Hill* cases, judicial review as to Section 801 should continue as in the past. It has been held that the judicial review provisions of the APA, at least insofar as availibility of review is concerned, are declaratory of previously existing law. *Olin Industries vs. NLRB* (1947 DC), 72 F. Supp. 225. Judicial review should now be afforded under the principle announced in U. S. ex rel *Trinler vs. Carusi* (C.A. 3d, 1948) 166 F. 2d 457, vacated on other grounds. It was there held that judicial review would not be denied in instances in which it had been traditionally afforded in spite of the language of Section 10 to the contrary.

In the case of *Snyder vs. Buck* (1948 D.C. Dist.Col.) 75 F. Supp. 902, vacated on other grounds (85 App. D.C. 428), the court stated:

> "Subsection (a), Section 10, confers the right to secure a judicial review on any person adversely affected or aggrieved by an agency act within the meaning of any relevant statute. The effect of this provision is, on the one hand, to exclude from the right of judicial reveiw all

governemental action affecting the public generally, but not impinging on the legal right of an individual; and on the other hand, to permit an appeal to the courts by any person whose individual legal rights are adversely affected.

A second recognized authority has the following to say regarding the second exemption:[2]

"The other exception of action 'committed to agency discretion' has, perhaps understandably, created a certain confusion and uncertainty. The further provisions of the judicial review section make it clear that the mere presence of agency discretion does not oust review. Under the heading, 'Scope of Review,' an agency action may be set aside for 'an abuse of discretion' which clearly implies reviewability despite the presence of discretion.

"As one court has said, '...almost every agency action "involves" an element of discretion or judgment....' This is not to be taken as a plea for judicial interference with discretion; the argument is rather that *the presence of discretion should not bar a court from considering a claim of illegal or arbitrary use of discretion.* Occasionally, lower courts have been troubled by the APA discretionary exception. One case, *Hiatt vs. Compagna* (178 F. 2d 42 5th Cir. 1949) affirmed by an equally divided Court (340 U.S. 880 1950) is unusually instructive. *Compagna* was paroled. Unfavourable newspaper publicity led to a Congressional investigation. A new parole board told a Congressional committee that they saw no reason for revoking

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[2] Jaffe, Judicial Control of Administrative Action, 374-375 (1965). See also Schwartz, The Administrative Procedure Act in Operation, 29 New York L. Rev. 1173 at 1246-1247 (1954); Berger, Administrative Arbitrariness and Judicial Review, 65 Col. L. Rev. 55 (1965);"Developments in the Law: The Federal Food, Drug and Cosmetic Act" 67 Harvard L. Rev. 632 at 675, in conjunction with its footnotes 328 and 394 (1954).

> the parole, but on the Committee's request promised to and then did revoke the parole. The Court of Appeals, observing that the provision of the statute 'bristle with discretion,' held the action nonreviewable under the Administrative Procedure Act. Yet it instructed the lower court that if the order was a 'total nullity' the court might in the exercise of its general equity power set the order aside. The district court then called upon the parole board to produce its evidence for revoking the parole, and finding that there was no 'substantial evidence' of parole violation, ordered *Compagna* released. The upshot is that *there are vey few discretions, however broad, substantially affecting the person or property of an individual which cannot at some point come under judicial surveillance...*" (Emphasis by Jaffe)

3. Legislative history indicates that judicial review is available.

The legislative history of the FDC Act underlines the validity of Jaffe's commentary in supplying evidence that Congress did not wish to exclude the possibility of judicial review of agency actions.

Prior to the commencement of lengthy hearings which were to culminate in the passage of the 1938 FD&C Act came the aforementioned *Ambruster vs. Mellon*, supra, the first of two major cases in which a federal court did, in fact, review FDA import adjudications. The District Court did note the existence of this and a second case, the *James J. Hill*, supra, which, as stated above, did provide legal precedent for the appellant's first pleas. However, the District Court chose to discount the value of this legal precedent. First it noted irrelevantly that the petitioner in both cases lost, and then

it claimed that the fact that both cases antedated the passage of the APA (1946) and the decision of *Larson vs. Domestic and Foreign Commerce Corp.*, (1949) 337 U.S. 682, made their validity questionable. The appellant, on the other hand, sees the timing of *Ambruster* and *Hill* as a factor enhancing his claim to judicial review. *Ambruster* occurred in the days of the 1906 Act. Aware that review of an import determination had been undertaken under the old act, Congress could well have added a clause to the 1938 Act excluding such a possibility had it so desired. The fact is that Congress incorporated the old import section into the new law in a form that was in every respect the same, except for very slight changes in some language.[3] Thus it was not surprising that the courts undertook to review the second case, *Hill*, on the validity of an import adjudication after the passage of the new law, whose basic import section, incidentally, Congress has still not seen fit to change twenty-one years later.

That Congress did not take advantage of its opportunities to exclude by statutory provisions the possibility of judicial review in import adjudications is significant. The question

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[3] Modified statement of then Commissioner of Food and Drug Administration, Walter Campbell, before a Subcommittee of the Senate Committee on Commerce on S. 1944, 73rd Cong. 2d Sess. (1933) reprinted in Dunn, *Federal Food, Drug and Cosmetic Act: A Statement of Its Legislative Record* 1102 (1938). This was the extent of the legislative history in regard to import Section 801.

remains, however, of what its motivation was in specifying review procedures for some agency actions and not for others such as import adjudications. Here the *Abbott Laboratories, et al., vs. John W. Gardner,* supra at 141-143, opinion is instructive and worth quoting at length:

> "...we must go further and inquire whether in the context of the entire legislative scheme the existence of the circumscribed remedy evinces a congressional purpose to bar agency action not within its purview. From judicial review as a leading authority in this field has noted: 'The mere fact that some acts are reviewable should not suffice to support an implication of exclusion as to others. The right to review is too important to be excluded on such slender and indeterminate evidence of legislative intent.' Jaffe, *supra,* p. 357.
>
> "In this case the Government has not demonstrated such a purpose; indeed a study of the legislative history shows rather conclusively that the specific review provisions are designed to give an additional remedy and not to cut down more traditional channels of review. At the time the Food, Drug and Cosmetic Act was under consideration, in the late 1930's, the Administrative Procedure Act had not yet been enacted, the Declaratory Judgment Act was in its infancy, and the scope of judicial review of administrative decisions under the equity power was unclear. It was these factors that led to the form that statute ultimately took. There is no evidence at all that members of Congress meant to preclude traditional avenues of judicial relief. Indeed, throughout the consideration of the various bills submitted to deal with this issue, it was recognized that 'there is always an appropriate remedy in equity in cases where an administrative officer has exceeded his authority and there is no adequate remedy of law,...(and that) protection is given by the so-called Declaratory Judgment Act....' *H.R. Rep.* No. 2755, 74th Cong. 2d Sess., 8. It was specifically brought to the attention of Congress that such methods had in fact been used in the food and drug area, and the Department of Justice, in opposing the enactment of the special review procedures of Section 701, submitted a memorandum which was read on the floor of the House

> stating: 'As a matter of fact, the entire subsection is really unnessary, because even without any express provision in the bill for court review, any citizen aggrieved by any order of the Secretary, who contends that the order is invalid, may test the legality of the order by bringing an injunction suit against the Secretary, or the head of the Bureau, under the general equity powers of the court.' *83d Cong. Rec.* 7892 (1938)."

It can readily be seen that the FD&C Act does not contain the "clear language of supersedure" without which the Supreme Court feels "the expanded mode of review granted by ...(the APA) cannot be modified." *Brownell vs. Wo Shung*, supra at 185.

The appellant concludes argument on his first point, that the FDA action which is the basis of this suit, is without question, subject to judicial review, by quoting the highest court of the land:

> "Compare the majority and minority reports on the review provision (Federal Food, Drug and Cosmetic Act), *H.R. Rep.* No. 2139, 75th Cong. 3d Sess. (1938), both of which acknowledged that traditional judicial remedies were available, but disagreed as to the need for additional procedures. The provisions now embodied in a modified form in Section 701(f) were supported by those who feared the life-and-death power given by the Act to the executive officials, a fear voiced by many members of Congress. The supporters of the special review section sought to include it in the Act primarily as a method of reviewing agency factual determinations....
>
> "Some congressmen urged that challenge to this type of determination should be in the form of a *de novo* hearing in a district court, but the Act as it was finally passed compromised the matter by allowing an appeal on a record with a 'substantial evidence' test, affording a considerably more generous judicial review than the 'arbitrary and capricious' test available in the traditional injunctive suit."
> *Abbott Laboratores, et al., vs. John W. Gardner, et al.*, supra, at 143.

FAIR HEARING PROCEDURES ARE REQUIRED IN THE MAKING OF IMPORT ADJUDICATIONS BY THE FDA

This action was brought by a salvor in order to be relieve of the burden of illegal administrative procedures utilized by the respondents. The appellant contends that he is entitled to a fair hearing under the Administrative Procedures Act and the Food, Drug and Cosmetic Act, and that there is no sound basis for depriving him of his property without affording him said fair hearing.

A. Fair Hearings Are Required By The Administrative Procedures Act.

1. The act's legislative history supports this thesis:

The intent of Congress as manifested by the legislative history of the Administrative Procedures Act establishes the applicability of the hearing provisions to all administrative agencies, including the Food and Drug Administration.

The Administrative Procedures Act was enacted after ten years of exhaustive study and consideration. The Senate Report of 1939 *(S. Rept. No. 442, 76th Cong., 1st Sess.)* is just one of the documents which gives insight into the thinking which underlay its passage. The following portions found on pages 9 and 10 concern the negative effects of the situation then pertaining in which government agencies were not required to conduct hearings according to uniform fair procedures:

> "Unfortunately, the statutes providing for fair hearings before the so-called independent

agencies of the Federal Government, as well as those providing for the conduct of affairs of the single-headed agencies, do not provide for uniform procedure for...hearings or for a uniform method of scope of judicial review. All argument that such uniformity is neither possible or desirable is answered by the fact that uniformity has been found possible and desirable for all classes of both equity and law actions in the court exercising the whole of the judicial power of the Federal Government. It would seem to require no argument to demonstrate that the administrative agencies, exercising but a fraction of the judicial power may likewise operate under uniform rules of practice and procedure and that they may be required to remain within the terms of the law as to the exercise of both quasi-legislative and quasi-judicial power.

"The results of the lack of uniform procedure for the exercise of quasi-judicial power by the administrative agencies have been at least three-fold: (1) the respective administrative agencies give little heed to, and are little assisted by, the decisions of the courts applicable to such agencies; (2) the courts are placed at considerable disadvantage because they must verify the basic statutes of all decisions relating to other administrative agencies which are cited to them, thus slowing up the writing of opinions in particular cases; and (3) individuals and their attorneys are at a disadvantage in the presentation of their administrative appeals, with the result that there is a tendency to emphasize the importance of the judiciary in the administrative process... Furthermore, the statutes, commencing with the Interstate Commerce Act, have made no provision whatever for improvement of the administrative process and rarely have these statutes admitted to prescribe even in a general way, the scope of judicial review. The result has been that the administrative agencies and the courts have been required to work out the procedure from case to case with unnecessary fumbling in the administrative process and with unnecessary criticism of the courts when they have attempted--not altogether with success--in their decisions to lay down general rules of trial and appellate procedure."

The Attorney General's Committee on Administrative Pro-

cedure, appointed in 1941, stated another representative viewpoint in its proposed administrative act:

> "The exercise of administrative powers, insofar as they affect private rights, privileges or immunities, should be effected by established procedures designed to insure adequate protection of private interest and to effectuate the declared policies of Congress. While procedures should be conducted of the necessities and differences of legislation, and of the subject matter involved, they should, in any event, be made known to all interested persons. Administrative adjudication should be attended by procedures which assure due notice, adequate opportunity to present and meet evidence and argument and prompt decisions."
>
> *Administrative Procedure in Government Agencies Report of the Committee on Administrative Procedure, Appointed by the Attorney General at the Request of the President, to Investigate the Need for Procedural Reform in Various Administrative Tribunals and To Suggest Improvements Therein* (S. Doc. No. 8, 77th Cong., 1st Sess., dated January 22, 1941).

One of the concerns brought out during the House Proceedings was as follows (*House Committee on the Judiciary, House Report No. 1980*, May 3, 1946):

> "Manifestly, the bill does not unduly encroach upon the needs of any legitimate government operation, although it is, of course, operative according to its terms, even if it should cause some administrative inconvenience or change in procedure...functionally, classifications and exemptions have been made, but in no part of the bill is an agency exempted by name. The bill is meant to be operative 'across the board' in accordance with its terms, or not al all..."

It would seem to be altogether apparent that the intent of Congress was to regulate the so-called "fourth branch" of government for the purpose of safeguarding individual rights.

Its goal was to assure judicial fairness, tantamount to that guaranteed by the U.S. Constitution, in the government agency adjudication process. Its means of carrying out its intent was to provide that hearings be conducted in accordance with standards similar to those utilized by the judiciary.

The appellant maintains that he should have been afforded such a hearing during the adjudication out of which this action arises.

2. Case law supports liberal interpretation of the Administrative Procedure Act.

In the *Japanese Immigrant Case* (1903) 189 U.S. 86, 191, the Supreme Court commented that requirements of procedural due process are derived from the same source as Congress' power to legislate, and where applicable, permeate every valid enactment of that body. The Court stated:

> "....In the case of all acts of Congress, such interpretation ought to be adopted as, without doing violence to the import of the words used, will bring them into harmony with the Constitution."

In both *Pan-Atlantic S.S. Corp. vs. Atlantic Coast Line R. Co.*, (1956) 353 U.S. 436, and *Wong Yang Sung vs. McGrath*, (1949) 339 U.S. 33, the court became more specific in terms of the present case. It declared that the APA is a remedial and reform piece of legislation, and, as such, should be liberally construed. The *Wong* case, which will be more fully discussed presently, involved the legitimacy of a deportation order under the Immigration Act and the right of the aggrieved party to a hearing in accordance with the provisions of the

APA. The Supreme Court concluded that the APA provisions affording hearings should be liberally construed.

3. The District Court erred in determining that an exception in §554(a) precludes fair hearings in import adjudications.

The appellant maintains that the FDA should have made the adjudication required by the Food, Drug & Cosmetic Act, Section 801, according to the terms of Administrative Procedure Act, Sections 554, 556 and 557. On this point, the District Court's argument is that these sections are not applicable due to the following wording contained in Section 554(a):

> "This section applies, according to the provisions thereof, in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing."

Since the FD&C Act, Section 381, does not contain a provision expressly requiring an adjudication to be determined "on the record," the District Court feels that all three APA sections are inapplicable.

Let us examine a Supreme Court case revolving around these very words of APA 554(a). In the aforementioned *Wong Yang Sung vs. McGrath*, supra, it will be remembered that the issue was the legitimacy of a deportation order when the immigration authorities had not given Wong a fair hearing according to APA standards.

In *Wong*, there were more statutory barriers to the application of Sections 554-7 than in the present case. Not only

did the Immigaration Act fail to provide that the adjudications be decided on the record after a hearing, but it also failed to mention that a hearing be held at all. Section 801 of the FD&C Act does specify that a hearing be held when it instructs the FDA to "give notice thereof to the owner or consignee, who may appear before the Secretary of Health, Education and Welfare and have the right to introduce testimony."

Because of case law rather than statutory requirements, immigration authorities did hold deportation hearings in actual practice. The manner in which they were conducted by immigration authorities, prior to the *Wong* case, was the same as that in which hearings on the admissibility of imports have been conducted by the FDA, i.e., immigrants threatened with deportation were simply given an opportunity to speak on their own behalf.

The Supreme Court ruled that this procedure was inadequate for the protection of individual rights. In light of the fact that court decisions had added hearings to deportation proceedings, it dismissed the barriers that the Immigration Act itself required neither hearings nor that determinations be based upon the record. Thus, lacking the statutory support available in the present case, Wong nevertheless won his case.

It should be pointed out that the Supreme Court was not unmindful of the effects which its decision would have on the government agency involved. In this respect, *Wong*, supra, stated:

> "Nor can we accord any weight to the argument that to apply the Act to such hearings will cause inconvenience and added expense to the Immigration Service. Of course it will, and as it will to nearly every agency to which it is applied, but the power of the purse belongs to Congress and Congress has determined that the price for greater fairness is not too high. The agencies, unlike the aliens, have ready and persuasive access to the legislative ear and if error is made by including them, relief from Congress is a simple matter."

After the decision by the United States Supreme Court that the APA applies to deportation hearings, immigration authorities did indeed go to Congress. They subsequently secured a fair procedure for deportations, modeled on pertinent portions of the Administrative Procedure Act but adapted to the particular needs of the deportation process. As far as we know, the FDA has not chosen to take comparable steps. In light of the clear dictum of the *Wong* case, the appellant maintains that the agency should be governed by the APA until it does.

4. The District Court erred in determining that an exception in §554(a)(3) precludes fair hearings for import adjudications.

The government, pursuing its point that adjudication under the FD&C Act, Section 801, is not subject to APA rules, cites APA 554(a)(3). This provision excludes from the general hearing requirements cases which involve "proceedings in which decisions rest solely on inspections, test or elections." As an aid to interpreting these words, rules of statutory construction should be applied.

As noted above, a remedial statute such as the APA is entitled to liberal construction. *(Abbott Laboratories vs. Gardner,* supra.) The corollary principle is that such statutes are to be strictly construed. Thus, a proviso which operates to limit the application of the provision of the statute should be held to include no case not clearly within the purpose, letter, or express terms of the proviso. *(Piedmont & N. R. Co. v. Interstate Commerce Commission* (1932) 286 U.S. 299; *Gregg Cartage & Storage Co. v. United States* (1942) 316 U.S. 74.)

The exemption dealing with inspections and tests has been interpreted by the Supreme Court in just such a strict manner. Exemption has been confined to instances in which there are explicit, definitive standards, such as those of the Tea Importation Act, to be applied. (See discussion of Tea Importation Act below.) In the case of *Door v. Donaldson,* 195 F. 2d 764 (1952), the court stated as follows:

> "In our opinion the act exempts from the requirements of a full hearing, because they 'rest solely upon inspections,' only decisions that turn either upon physical facts as to which there is little room for difference of opinion, or else upon technical facts like the quality of the tea...."

Quite obviously the present circumstance is not within the purview of this exception. There was no definitive, explicit standard for judging the coffee, nor was the determination made upon physical facts as to which there was "little room for difference of opinion." The government *a fortiori* did not even draw upon the standards set by the coffee industry

itself in determining the quality and fitness of the product. On the contrary, the decision as to fitness was based admittedly upon a subjective examination by various personnel within the agency, whose thoughts, opinions and determinations were not based upon any standard procedure, rules or regulations.

In reviewing the cases mentioned above, it can be seen that the higher courts have consistently reaffirmed the intent of Congress, in its passage of the Administrative Procedure Act, by applying APA hearing provisions in the interest of individual protection. The appellant maintains that the District Court erred in failing to follow this precedent.

B. Fair Hearings Are Required by the Federal Food, Drug and Cosmetic Act.

1. An analysis of its pertinent provisions in the light of rules of statutory construction bears out this contention.

Section 801 specifies that an import adjudication be made only after the owner of the goods in question is given notice, an opportunity to appear before a representative of the Department of Health, Education and Welfare, and the right to introduce testimony. The procedure described is certainly tantamount to a hearing, and certain rules of statutory construction compel the conclusion that this terminology of Section 801 is to be construed to mean a hearing.

In the interpretation of statutes, some degree of implication traditionally may be called upon to aid the discovery of the intention of the legislature. *(Mercantile Trust Co.*

v. Road Dist. (1927) 275 U.S. 117.) That which is implied from the express terms of a statute is as much a part thereof and is as effectual as that which is expressed. *(Luria v. United States* (1913) 231 U.S. 9.) Moreover, in the absence of a contrary indication, legislative enactments which are prospective in operation and which are couched in general and comprehensive terms apply to new situations which arise. *(Feitler v. United States,* (CA-3, 1929) 34 F.2d 30; *Buck v. Jewell-LaSalle Realty Co.,* (1931) 283 U.S. 191.) According to these three rules, Section 801 constitutes a basis upon which a fair hearing is to be granted. The language implies a hearing, and the appellant will presently support his contention that a hearing is what Congress had in mind. But even if Congress, in enacting these procedures with respect to notice, opportunity to appear, and the right to introduce testimony, did not specifically envisage a "hearing," the language is prospective in nature and is broad enough to include the new situation which, in this particular case, is the hearing now afforded by and provided for by the APA.[4]

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[4] The FDA itself ascribes to these rights, the word, "hearing". It sent to the importer a form entitled, "Notice of Hearing". In this respect, a rule of statutory construction maintains that the Executive Department charged with the administration or enforcement of such rules of procedure is entitled to the highest respect. *(United States v. Bergh* (1956) 352 U.S. 40.) If the FDA itself deems this language to mean a hearing, then the appellant believes the court should acknowledge its interpretation.

Other rules of statutory construction further confirm the premise that Section 801 of the FDC Act requires a hearing. The legislature is presumed to have enacted a statute directed toward achieving a just result. *(Washington Terminal Co. v. Boswell* (1941) 124 F.2d 235, (affirmed in 319 U.S. 732); *United States v. City National Bank of Duluth* (1939) 31 F.Supp. 530.) It is not presumed to have intended to provide for the performance of a vain, idle or futile act, nor to produce an absurd consequence. *(United States v. American Trucking Associations* (1940) 310 U.S. 534, rehearing denied 311 U.S. 724; *Armstrong Paint and Varnish v. Nu-Enamel Corporation* (1938) 305 U.S. 315.) Furthermore, that construction of a statute which affords an opportunity to evade an act should be avoided, and conversely, construction which would defeat subterfuges or evasions of the intent of the statute is to be favored. *(Scarborough v. Atlantic Coast Line R. Co.* (1949) (CA 4th Va.) 178 F.2d 253.) Let us look at Section 801 in terms of these ground rules. It would seem that the intent of Congress in suggesting that the importer be given an "opportunity to introduce testimony" could be only its desire to assure that the importer's rights were not infringed upon in an arbitrary manner. Yet how is the protection of the importer's rights to be guaranteed if the agency is allowed simply to disregard the testimony if it so chooses? The agency's listening to but totally ignoring the case presented by the importer is a quite possible, but vain, unjust and absurd consequence of an interpretation which deems that Section

801 does not imply a fair hearing with the determination made on the record.

Still another rule of statutory construction is that the court will strive to avoid an interpretation of a statute which produces capricious distinction or discrimination between situations which are not substantially different. *Talbott v. Silver Bow County* (1890) 139 U.S. 438; *Wilson v. Federal Communications Comm.* (1948 C.A.D.C.) 170 F.2d 793. To formulate separate, distinct hearing rules with respect to the promulgation of regulations and the making of adjudications is to promote a senseless distinction. Logic demands we recognize that there is no sound reason why a hearing should be granted in one instance and not in the other. The safeguards provided by the APA in the form of a hearing should apply in each instance. If anything, there is greater need for the right to a hearing with respect to the adjudicatory function, for, in the final analysis, adjudicatory decisions must be based upon a subjective analysis of the evidence as presented.

2. The District Court erred in determining that an FDC Act provision precludes fair hearings in import adjudications.

(a) It improperly emphasized a single phrase rather than interpreting the Food, Drug and Cosmetic Statute in its entirety.

The District Court erred in virtually ignoring the

pertinent portions of Section 801 just analyzed and in relying almost exclusively on other language in that section, to wit:

> "If it appears from the examination of such samples or otherwise that....(3) such article is adulterated...then such article shall be refused admission...."

It is an elementary rule of statutory construction that significance and effect should be accorded every part of an act. *(United States v. Alpers* (1950) 338 U.S. 680; *D. Ginsberg & Sons v. Papkin* (1932) 285 U.S. 204.) The maxim, *ut res magis quam perat* requires not merely that a statute be given effect as a whole, but that effect should be given to *each* of its express provisions. *(Pennsylvania Co. v. United States* (1915) 236 U.S. 351.) Further, all parts of the act should be considered, compared and construed together. It is not permissible to rest a construction upon any one part alone or upon isolated words, phrases, clauses or sentences. *(Hellmich v. Hellman* (1928) 276 U.S. 233; *International Mercantile Marine Co. v. Lowe* (1938) (CCA 2d) 93 F.2d 663 (writ of certiorari denied in 304 U.S. 565.) In addition, each statute or section is to be construed in light of, with reference to, and in connection with other statutes or sections. *(Textile Mills Securities Corp. v. Commissioner of Internal Revenue* (1941) 314 U.S. 326.)

A Federal Court reiterated these maxims in *U. S. v. 88 cases, etc...Bireley's Orange Beverage* (1946) 5 F.R.D. 503, where it was held that the Federal Rules of Civil Procedure applied to the FD&C Act after this analysis:

"In interpreting the statute in question we must look to the entire statute and not to the single phrase."

In applying these rules of statutory construction, it is elementary that undue emphasis cannot, as the government would wish it, be placed upon a sentence or phrase which may appeal to a particular party. The language of the statute which deals with notice, opportunity to appear, and the right to introduce testimony must be considered in conjunction with the language which states that if it appears from the examination of a sample or otherwise that such article is adulterated then such article shall be refused admission. The two are entitled to equal weight, and, if at all possible, are to be interpreted so as to give effect to both. In this regard, it is consistent and logical to construe the two pertinent portions of Section 801 to mean the following: that a person is entitled to a hearing and entitled to a determination based upon a record, and that if a person does *not* desire to avail himself of these privileges, then, *and only then*, may the government exclude the particular article offered for import "if it appears from a sample or otherwise that the article is adulterated....". The words, "or otherwise" are of particular importance here and lend credence to the interpretation which appellant contends is logical and consistent. The "or otherwise" provides for cases where there is a controversy, and in which a hearing has been in fact requested and conducted. This interpretation is, in fact, the only interpretation that does not do violence to the pertinent

portions of Section 801 and does not unduly emphasize one section over the other.

(b) The District Court mistakenly ascribed Tea Inspection Act standards to the FDC Act.

In rejecting the necessity for a fair hearing in the present case, the District Court relied heavily upon *Buttfield v. Stranahan,* (1903) 192 U.S. 470, which involved an administrative refusal to admit into the United States a shipment of tea found by a Board of General Appraisers to be below certain standards set by the Secretary of the Treasury. The District Court mistakenly applied the principles in *Buttfield v. Stranahan* to invest the FDA with completely discretionary powers. However, an examination of the two separate acts upon which *Buttfield* and the present case rest, i.e., the Tea Inspection Act and the Food, Drug and Cosmetic Act, shows that they are quite distinct from each other.

The Tea Importation Act was enacted in 1897 and provides that the government, upon recommendation by a board of experts, shall fix and establish uniform standards of purity, quality and fitness for consumption of all kinds of teas imported into the United States. The quality of any tea in question shall be tested and graded according to the usage and customs of the tea trade, including the testing of an infusion of the same in boiling water and, if necessary, chemical analysis. The Food, Drug and Cosmetic Act, on the other hand, does not require the government to set standards and grades for coffee, and the government thus has not done so. If, however, there

were such a requirement, the importer then could challenge these coffee standards under the statutory procedures of the FD&C Act, Section 701 or the Administrative Procedure Act. However, even in the Tea Importation Act, there is a specific statutory procedure for a fair hearing, and, in matters of dispute, access to decision review by the U. S. Board of Tea Appeals.

(c) The District Court ignored specific wording which indicates an assumption that fair hearings will be part of the adjudication process.

Section 701 (e)(1) states in part:

> "Any action for the issuance, amendment, or repeal of any regulation under Section 401, (concerns definitions and standards for food), 403 (j) (concerns misbranding), 404(a) (concerns emergency permit control), 406 (concerns tolerances for poisonous ingredients in food), 501(b), or 502(d) or (h) (concerns drugs) shall be begun... (a procedure is then specified for putting the action into effect.)"

Section 701(e)(2) continues:

> "...any person who will be adversely affected by such order if placed in effect may file objections thereto with the Secretary, ...requesting a public hearing upon such objections."

Section 701(c) says:

> "Hearings authorized or required by this Act shall be conducted by the Secretary or such officer or employee as may be designated for the purpose."

Section 701(g) reads as follows:

> "A certified copy of the transcript of the record and proceedings under sub-section (e) shall be furnished by the

> Secretary to any interested party... and shall be admissible in any criminal libel for condemnation exclusion of imports, or other proceeding arising under or in respect of this Act...."

The impact of these provisions on the present case can be stated succinctly as follows: transcripts of hearings dealing with such matters as the promulgation of regulations fixing food standards "shall be admissible" at exclusion of import proceedings. The appellant feels it is highly significant that the writers of the law eschewed such language as "can be presented." Wording such as that might be seen as being consistent with the FDA's interpretation as to the character of the hearing authorized in Section 801. The language which actually was used is of a totally different character. "Shall" is imperative, not permissive. "Admissible" is a technical legal term, defined as follows in *Black's Law Dictionary*, 4th ed.:

> "Pertinent and proper to be considered in reaching a decision. Used with reference to the issues to be decided in any judicial proceedings.
>
> As applied to evidence, the term means that it is of such a character that the court or judge is bound to receive it; that is, allow it to be introduced."

The appellant maintains that the wording of Sections 701(e), (c) and (g) constitutes ample evidence that the import exclusion hearing proceeding envisaged by the enactors of the law is not an empty formality, in which the hearing officer can listen in patronizing fashion to an aggrieved party but is free to ignore what is said. On the contrary, the hearing

officer "is bound to receive" transcripts and other admissible evidence. Does this not clearly imply that a fair hearing is to be held, the rules for which have since been specified by the Administrative Procedure Act?

III

THE DISTRICT COURT ERRED IN GRANTING A SUMMARY JUDGMENT

A. Its Decision Was Contrary to the Intent and Provisions of the APA.

Professor Davis, supra, at page 27-28 of his 1965 Pocket part, inquires:

> "Is it good government--is it sound law--that permits a single individual to determine issue of law, fact, and discretion, affecting the property rights....., without hearings, without review, without disclosure of the rules that are used to guide discretion, and without opening to public inspection the resulting law?"

In affirming that the District Court erred in granting the FDA a summary judgment in the present case, the appellant respectfully commends to the Appellate Court Professor Davis' answer to his own question:

> "A review court, without at any point substituting judgment, could (a) determine the reasonableness of the rules developed by the administrator as a guide to discretion, (b) require that those rules be open to public inspection, (c) ascertain whether the particular exercise of discretion arbitrarily departs from the administrative case law, (d) require that the administrative case law be open to public inspection in compliance with §3(b) of the Administrative Procedure Act, (e) require findings of fact and a statement of reasons, (f) determine whether the findings are supported by substantial evidence, (g) determine whether the stated reasons are based upon considerations which are reasonable and legal."

1. The District Court should have exercised the authority to review agency actions given it by the APA.

APA Section 10(e) 5 U.S.C. 701(e), entitled, "Scope of Review," provides:

> "To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning of applicability of the terms of an agency action. The reviewing court shall--
>
> 1) compel agency action unlawfully withheld or unreasonably delayed; and
> 2) hold unlawful and set aside agency, action, findings, and conclusions found to be--
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
>
> (B) contrary to constitutional right, power, privilege, or immunity;
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
>
> (D) without observance or procedure required by law;
>
> (E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or
>
> (F) unwarranted by the facts to the extent that the facts are subject to trial *de novo* by the reviewing court.
>
> In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of prejudicial error."

The law thus clearly invests the District Court with the

power to "set aside agency action." The appellant proposes to show that the court should have acted on this power, on the grounds that the FDA's adjudication was made "not in accordance with law" and that it was "unsupported by substantial evidence."

2. The District Court should have reviewed the issues of law involved.

In *U. S. vs. 449 cases...Tomato Paste*, (C.C.A. 2d 1954) 212 F.2d 567, concerning an allegedly adulterated product from Portugal which had been seized within the United States, the dissenting opinion of Justice Frank included the following admonition to his peers:

> "Our responsibility goes beyond the adjudication of the validity of the legislative grant. It includes the duty of scrutinizing the methods employed in the process of administrating the granted power. Unless this power is in some way constrained (as I believe it has been by the Administrative Procedure Act) it permits dangerous administrative arbitrariness...."

The appellant shares both Justice Frank's concern regarding the methods employed in the process of administrating the granted power and his belief in the efficacy of APA safeguards.

(a) The FDA deprived petitioner of information to prepare for a hearing.

The APA emphasizes in provision after provision that government agencies are to make full disclosure of matters pertaining to adjudications. APA, Section 556, states:

> "The transcript of testimony and exhibits, together with all papers and requests filed

in the proceeding, constitutes the exclusive record for decision in accordance with Section 557 of this title and, on payment of lawfully prescribed costs, shall be made available to the parties."

APA, Section 557(c)(3), says in part:

"All decisions, including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of--

(A) findings and conclusions and, the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record."

APA Section 554(b) says:

"Persons entitled to notice of an agency hearing shall be timely informed of--

(3) the matters of fact and law asserted."

Section 552(d) deals with access to Public Records:

"Except as otherwise required by statute, matters of official record shall be made available, in accordance with published rule, to persons properly and directly concerned..."

In addition, the FDA's own regulation, 21 CFR 4.1(c) entitled "Disclosure of Official Records and Information," states:

"A person who desires the disclosure of any such record or information may make written request therefor, verified by oath, directed to the Commissioner of Food and Drugs, setting forth his interest in the matter sought to be disclosed and specifically designating the use to which such records of information will be put in the event of compliance with such request..."
(Pet. Exhibit "D" and "E".)

The importance of reasonable access to government information has been further expressed in the Public Information

Act of 1966 (Public Law 89-487) which amended Section 552 of the APA. Under this legislation, executive agencies are required to adopt new guidelines to insure full disclosure of information affecting individuals.

Compare these numerous provisions with the actual methods of operation employed by the FDA.

On July 21, 1966, the FDA issued a "Notice of Detention and Hearing" on the grounds that the coffee beans in question were adulterated. The basis for the alleged adulteration was stated as follows: "The article is unfit for food since the beverage made from it after roasting is nearly devoid of flavor and color characteristics of normal coffee."

Almost any commercially-sold coffee is composed of a blend of more than one type of coffee, the purpose of mixing coffees being to enhance flavors and to satisfy varying consumer preferences. Naturally-bitter coffees are balanced by being blended with naturally-mild types. Thus, there is a genuine usefulness for many varieties of coffee beans which would be too strong or too weak by themselves.

The owner of the coffee beans in question consulted with food scientists who gave as their opinion that the product had value as a food when used as an element in blended coffee. Since the government had decreed otherwise, the owner felt that he needed access to data concerning the objective criteria by which the government had judged the product to be unfit. Lacking such information, he could not make a meaningful preparation for the hearing.

Thus, from August 18, 1966, until the "hearing" on January 6, 1967, the owner's attorney attempted to secure from the FDA information concerning the scientific basis for the detention of the coffee beans. One of the answers, as contained in Petitioner's Exhibit "C" typified the rest:

> "We are also unable to comply with your broad request for copies of all of our analyses and related reports pertaining to this detention and hearing. However, we can advise you that our Bureau of Science examined a beverage made from this coffee after roasting and found it to be nearly devoid of the flavor and color charactertistics of normal coffee. In view of this, we consider this coffee to be unfit for food within the meaning of section 402(a)(3) of the Act, a copy of which is attached. May we also direct your attention to Chapter VIII of the Act (page 75), on Imports and Exports."

The Supreme Court in *Simmons vs. United States* (1955) 348 U.S. 397 at 405, commented on another situation in which a government agency had not disclosed information in accordance with APA procedures, as follows:

> "A fair resume is one which will permit the registrant to defend against the adverse evidence--to explain it, rebut it, or otherwise detract from its damaging force... The Congress, in providing for a hearing, did not intend for it to be conducted on the level of a game of blind man's bluff..."

(b) FDA disregarded fact-finding procedures.

The Supreme Court in *Green vs. McElroy* (1958) 360 U.S. 474 at 496-497, expressed the following general principles:[6]

---

[6] See also *Kirby vs. Shaw* (CA-9, 1966) 358 F.2d 446; Cooper, "Should Administrative Hearing Procedures Be Less Fair Than Criminal Trials (1967) 53 ABAJ 237.

"Certain principles have remained relatively immutable in our jurisprudence. One of these is that where governmental action seriously injures an individual, and the reasonableness of the action depends on fact findings, the evidence used to prove the Government's case must be disclosed to the individual so that he has an opportunity to show that it is untrue. ...We have formalized these protections in the requirements of confrontation and cross-examination...This Court has been zealous to protect these rights from erosion. It has spoken out not only in criminal cases (citations), but also in all types of cases where administrative and regulatory actions were under scrutiny (ctiations). Nor, as it has been pointed out, has Congress ignored these fundamental requirements in enacting regulatory legislation ..."

To continue with the chronology of the FDA's actions: At the "hearing" on January 6, 1967, the Government presented no evidence that the coffee beans in question were adulterated. The hearing officer dismissed this essential element required for a fair hearing in the beginning, as follows: (Petitioner's Exhibit "I-1", page 13):

"MR. MC KRAY (Attorney for petitioner): Now, at this hearing, is the Food and Drug Administration going to present any evidence?

THE HEARING OFFICER: No. We are here to hear what you have to say."

After the petitioner presented his evidence for the record, the petitioner's attorney questioned the procedure for said hearing as follows, (Petitioner's Exhibit "I-1", pages 52-53):

"MR. MC KRAY: But the issue is that this hearing should comply with the fundamental principles of fair play, principles of fair play with the facts involved in the case.

I would like to point out at this time that

the Food and Drug Administration made no presentation at this hearing, nor has the Food and Drug Administration allowed the owner or consignee to examine any record or document involved in said coffee.

The second thing I would like to point out is this: Are you going to make the decision in this matter?

THE HEARING OFFICER: First, I would like to point out that we presented our position when we issued the Notice of Detention and Hearing, and this hearing is for the purpose of your presenting your position.

In answer to your second question, no, I probably will not make the decisiion. It will be probably be made in Washington.

MR. MC KRAY: Washington, D.C. will make the decision?

THE HEARING OFFICER: Yes."

The last exchange quoted has special significance in the light of APA §554(d):

"The employee who presides at the reception of evidence pursuant to section 556 of this title shall make the recommended decision or initial decision required by section 557 of this title, unless he becomes unavailable to the agency..."

On this matter the appellant cites *Steward vs. Penny*, (1965) 238 F. Supp. 821 at 827:

"We cannot, however, accept without limitation a contention that a high administrative official in Washington, D.C., is better qualified than others to analyse and draw conclusive fact inferences from a cold record produced at an evidentiary hearing three thousand miles away and relating to physical conditions with which he has questionable familiarity, conditions normally deemed to be within the realm of judicial notice. We deem the correct rule of judicial review to be that announced in *Foster vs. Seaton*, (1959) 106 U.S. App. D.C. 253, 271 F. 2d 836: 'Thus the case

> really comes down to a question whether the secretary's findings were supported by substantial evidence on the record as a whole.' This is the only rule of judicial review which will breathe vitality into the mandate of Congress (Administrative Procedure Act, 5 U.S.C., Section 1009(e)..) that the reviewing court shall 'hold unlawful and set aside agency actions, findings and conclusions found to be:
>
> (1) Arbitrary, capricious and an abuse of discretion or otherwise not in accordance with law;...
>
> (4) Without observance of procedure required by law;
>
> (5) Unsupported by substantial evidence in any case subject to requirements of Section 1006 and 1007 of this title or otherwise reviewed on the record of the agency hearing provided by statute....'"

The ninth circuit has also held that these administrative decisions must be based on hearing records having "a reasonable basis in law, and . . . are supported by substantial evidence." *Stockton Port District vs. Federal Maritime* (1966) 369 F. 2d 380 at 381.

3. In accordance with APA provisions which require decisions to be made upon the record, the District Court should have granted a summary judgment to the petitioner rather than to the government since there were no triable issues of fact. The FDA's import determination was unsupported by substantial evidence. APA 556(d) says in part:

> "A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts therof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence."

The appellant asks the court to examine the evidence

presented by the government at the "hearing." As summarized by the FDA hearing officer, ("... we presented our position when we issued the Notice of Detention and Hearing...."), the government's evidence consists of the statement: "Adulterated within the meaning of Section 402(a)(3). The article is unfit for food, since beverage made from it after roasting is nearly devoid of flavor and color characteristics of normal coffee."

APA 556(d) opens as follows:

> "Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof."

The appellant feels that without the burden of proof, the FDA's evidence is insufficient, and that with the burden of proof, it is impotent.

B. Even Without Consideration of APA Provisions Summary Judgment Should Not Have Been Granted the Government Because There Were Triable Issues of Fact.

In the instant case the District Court held that it did not have authority to review an FDA import determination. It did note *Ambruster v. Mellon and James J. Hill*, supra, allowing import determinations under the wording of Section 801 of the 1938 FD&C Act to be tried *de novo*. However, the District Court claimed that the fact that both cases antedated the passage of the APA (1946) made their validity questionable.

Since the District Court's deicision, the U. S. Supreme Court in another case involving the FD&C Act has given quite another interpretation as to the effect of the APA's passage

on earlier case law. It said:

> "...early cases in which this type of judicial review was entertained (citations) have been *reinforced* by the enactment of the Administrative Procedure Act...."
>
> *Abbott Laboratores v. Gardner*, supra, at 141. (Emphasis added.)

Thus, regardless of whether specific APA provisions are considered, early case law would seem still to be very much in effect and to decree that petitioners are indeed entitled to a trial *de novo*.

Let us consider the action which the District Court did take, however, i.e., the granting of a summary judgment to the government.

It is well established that a summary judgment should be granted only if there is no issue which calls for a trial. Rule 56(c) *Federal Rules of Civil Procedure; Fountain v. Filson* (1949) 336 U.S. 681; *Simler v. Conner* (1963) 372 U.S. 221 and *Poller v. Columbia Broadcasting System Inc.* (1962) 368 U.S. 462.

Following are a number of judicial commentaries on the subject:

In *Homan Mfg. Co. v. Long* (C.A. 7 - 1957) 242 F. 2d 207, it was held that a summary judgment proceeding was not a substitute for a trial but rather a judicial search for determining whether genuine issues exist as to material facts.

A summary judgment motion does not involve the trial of issues of fact but is rather in the nature of a preliminary

proceeding to ascertain whether or not there are genuine issues as to a material fact. *Burgert v. Union Pac. R. Co.* (C.A.8-195 240 F.2d 207 and *Dulansky v. Iowa-Illinois Gas & Elec. Co.*, (C.A.8-1951) 191 F. 2d 881.

The Court examines evidence on a motion for summary judgment, not to decide any issue of fact but to discover whether any real issue exists. *Ramsouer v. Midland Valley R. Co.*, (C.A 8-1943) 193 F.2d 318.)

In this action, the District Court was considering defendants' motion and a separate petitioner's motion for summary judgment. As verified above, its primary duty was to decide whether or not there were any facts which would give rise to a triable issue, not to pass upon or determine the issue itself. If that were not true, controversial issues of facts would be tried upon affidavits by the court and not by a jury. Here a triable issue of fact was present. It was provided by the original notice of hearing, to wit, WHETHER THE RECONDITIONED COFFEE BEANS WERE FIT FOR FOOD. The District Court, contrary to precedent, decided this issue of fact without a trial *de novo*. (IR. 22-26.)

The opposing declarations stated the triable issue, whether the reconditioned coffee beans are fit for food. The exhibits offered by both sides support the opposing contentions. Government's Exhibit 1 is offered in support of the negative position. Petitioner's Exhibit "I-1" (Reporter's Transcript of Administrative Hearing on January 6, 1967) and Petitioner's Exhibit "J" (Summary Report: "Quality of Recon-

ditioned Coffee," dated January 3, 1967) provide positive evidence that the reconditioned coffee beans are fit for food. Since there was a triable issue of fact, the District Court was then powerless to proceed further but should have allowed such issue to be tried by a jury unless a jury trial was waived.

The appellant takes issue not only with the outcome of the proceedings below, but with the procedure leading to the outcome.

First, the District Court ignored the petitioner's right to cross-examine witnesses and basic rules of evidence. (IIR. 2-9). Secondly, the District Court accepted Government Exhibits 1, 2, 3 and their respective subsections, although these exhibits were prepared by the FDA *after* the administrative hearing (IIR. 27-31).

The acceptance of Exhibits 2 and 3 is objectionable on other grounds in that they dealt with the condition of the coffee beans prior to their being offered for importation as reconditioned coffee beans. These exhibits are irrelevant and immaterial in determining whether the said reconditioned coffee beans are fit for food according to the reasoning given in *James J. Hill*, supra, at 269:

> "By Section 381 the Collector of Customs was authorized to refuse admission if the article was 'adulterated.' By Section 342 'a food shall be deemed to be adulterated...(3) if it consists in whole or in part of any filthy, putrid or decomposed substance, or if it is otherwise unfit for food....'. We may put aside in this case the words filthy and putrid,

> but it is the contention of the government that the damaged wheat was decomposed and otherwise unfit for food. There was substantial evidence, and indeed it is not disputed by the plaintiff, that there was some decomposition in the wet wheat and to some extent at least it was fermented and moldy.
>
> ...(however) it is important here to distinguish between the condition of the grain, when first offered for importation, and its condition after it had been dried. And it is also very important in this connection to note that there is really no controversy between the parties whether the wet grain before the drying was unfit for food of any kind, animal or human. In its original wet condition it was...so unfit for any kind of food. The controversy...as to its fitness for food is thus limited as to whether after being dried it was fit...."

Thus the appellant contends that the District Court erred in granting the government's motion for summary judgment. Instead appellant affirms that the District Court should have granted a trial *de novo* on the "Complaint and Petition for Writ of Mandatory Injunction" (IR 1-7).

CONCLUSION

The appellant's pleas are as follows:

1. The judgment of the District Court be reversed and the case remanded to the District Court.

2. Procedural guidelines be designated to provide the petitioner with a *fair hearing* to determine whether the reconditioned coffee beans are fit for food.

The appellant offers for the Court's consideration a variety of procedural paths designed to procure an equitable

outcome of the present case:

1. Under the Administration Procedure Act, allow the reconditioned coffee beans to enter the United States to be used for the production of blended coffee as supported by the administrative hearing record (Petitioner's Exhibit "I-1"). After the goods have been released from the physical custody of Customs, they will be subject to the domestic seizure provisions of the FD&C Act if the FDA still does not approve their importation. *230 Boxes of Fish v. United States* (C.A.6-1948) 168 F.2d 361. If a seizure action does occur, the petitioner will be entitled to a fair trial in the District Court.

2. Remand the case to the FDA for a determination of the substantive issue by an administrative hearing conducted in accordance with the provisions of the Administrative Procedure Act.

3. Remand the case to the District Court for a determination of the substantive issue by a trial *de novo*.

The entire import industry dealing with foods, drugs, and cosmetics will be affected by this decision. Clearly, administrative hearings conducted without procedural safeguards can be dangerous. The primary purpose of this appeal is to request the reviewing court to protect private rights, by stipulating that fair hearing procedures be used and reasonable access to government information be assured. The application of such procedures should serve to further the interests both of the individual and society, in that better

and fairer administrative decisions should result.

Dated: January 5, 1968, San Francisco, California.

Respectfully submitted,

GEORGE McKRAY and
SHELDON I. BLAMAN

GEORGE McKRAY

By _____
George McKray
Attorneys for Appelants.

STATE OF CALIFORNIA]
] No. 22,102
City and County of San Francisco]

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE A. McKRAY

George A. McKray
Attorney for Appellant

AFFIDAVIT OF SERVICE BY MAIL

STATE OF CALIFORNIA]
] No. 22102
City and County of San Francisco]

ROBERT L. JOHNSON, being duly sworn, says: That he is a citizen of the United States, over 18 years of age, not a party to the within action. This affiant's business address is 1255 Post Street, Suite 625, San Francisco, California. That affiant served copies of the attached APPELLANT'S OPENING BRIEF, on each of the following at their respective addresses by placing said copies in envelopes addressed as follows:

Cecil F. Poole
U. S. Attorney
Robert N. Ensign
Assistant U. S. Attorney
450 Golden Gate Avenue
San Francisco, Calif.
(3) copies

Arthur Dickerman, Esq.
FDA District Office
1521 W. Pico Blvd.
Los Angeles, Calif. 90015
(3) copies

which envelopes were then sealed and postage fully prepaid thereon, and thereafter were on January 5, 1968, deposited in the United States Mail at San Francisco. That there is delivery service by United States mail at the places so addressed, or regular communication by United States mail between the place of mailing and the places so addressed.

ROBERT L. JOHNSON

Robert L. Johnson

Subscribed and sworn to before me
this 5th day of January, 1968.

GRACE G. HACKETT

Grace G. Hackett, NOTARY PUBLIC
In and for the City and County of
San Francisco, State of California
My commission expires Feb. 9, 1971.

APPENDIX

I

STATUTES

Administrative Procedure Act, 60 Stat. 243 (1946) as amended, 5 U.S.C. §§ 552-558, 701-706 (1966)

§ 552. (formerly $1002) *Publication of information, rules, opinions, orders, and public records*

(c) Each agency shall publish, or in accordance with published rule, make available to public inspection all final opinions or orders in the adjudication of cases (except those required for good cause to be held confidential and not cited as precedents) and all rules.

(d) Except as otherwise required by statute, matters of official record shall be made available, in accordance with published rule, to persons properly and directly concerned, except information held confidential for good cause found.

§ 554. (formerly § 1004) *Adjudications*

(a) This section applies, according to the provisions thereof, in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved--

(1) a matter subject to a subsequent trial of the law and the facts de novo in a court;

(3) proceedings in which decisions rest solely on inspections, tests, or elections;

(b) Persons entitled to notice of an agency hearing shall be timely informed of--

(1) the time, place, and nature of the hearing;

(2) the legal authority and jurisdiction under which the hearing is to be held; and

(3) the matters of fact and law asserted.

(c) The agency shall give all interested parties opportunity for--

(1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment when time, the nature of the proceeding, and the public interest permit; and

(2) to the extent that the parties are unable so to determine a controversy by consent, hearing and decision on notice and in accordance with sections 556 and 557 of this title.

(d) The employee who presides at the reception of evidence pursuant to section 556 of this title shall make the recommended decision or initial decision required by section 557 of this title, unless he becomes unavailable to the agency. Except to the extent required for the disposition of ex parte matters as authorized by law, such an employee may not--

(1) consult a person or party on a fact in issue, unless on notice and opportunity for all parties to participate; or

(2) be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for an agency.

An employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review pursuant to section 557 of this title, except as witness or counsel in public proceedings. This subsection does not apply--

§ 556. (formerly §1006) *Hearings; presiding employees; powers and duties; burden of proof; evidence; record as basis of decision*

(a) This section applies, according to the provisions thereof, to hearings required by section 553 or 554 of this title to be conducted in accordance with this section.

(b) There shall preside at the taking of evidence--

(1) the agency;

(2) one or more members of the body which comprises the agency; or

(3) one or more hearing examiners appointed under section 3105 of this title.

* * * * *

The functions of presiding employees and of employees participating in decisions in accordance with section 557 of this title shall be conducted in an impartial manner. A presiding or participating employee may at any time disqualify himself. On the filing in good faith of a timely and sufficient affidavit of personal bias or other disqualification of a presiding or participating employee, the agency shall determine the matter as a part of the record and decision in the case.

(d) Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence. A party is entitled to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or applications for initial licenses an agency may, when a party will not be prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

(e) The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, constitutes the exclusive record for decision in accordance with section 557 of this title and on payment of lawfully prescribed costs, shall be made available to the parties. When an agency decision rests on official notice of a material fact not appearing in the evidence in the record, a party is entitled, on timely request, to an opportunity to show the contrary.

§ 557. (formerly §1007) *Initial decisions; conclusiveness review by agency; submissions by parties; contents of decisions; record*

(a) This section applies, according to the provisions thereof, when a hearing is required to be conducted in accordance with section 556 of this title.

(b) When the agency did not preside at the reception of the evidence, the presiding employee or, in cases not subject to section 554(d) of this title, an employee qualified to preside at hearings pursuant to section 556 of this title, shall initially decide the case unless the agency requires, either in specific cases or by general rule, the entire record to be certified to it for decision.

(c) Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions--

(1) proposed findings and conclusions; or

(2) exceptions to the decisions or recommended decisions of subordinate employees or to tentative agency decisions; and

(3) supporting reasons for the exceptions or proposed findings or conclusions.

The record shall show the ruling on each finding, conclusion, or exception presented. All decisions, including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of--

(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and

(B) the appropriate rule, order, sanction, relief, or denial thereof.

§ 558. (formerly §1008) *Imposition of santions; determination of applications for licenses; suspension, revocation, and expiration of licenses*

(b) A sanction may not be imposed or a substantive rule or order issued except within jurisdiction delegated to the agency and as authorized by law.

§ 701. (formerly §1009) *Application; definitions*

(a) This chapter applies, according to the provisions thereof, except to the extent that--

(1) statutes preclude judicial review; or

(2) agency action is committed to agency discretion by law.

§ 702. (formerly §1009(a)) *Right of review*

A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof.

§ 703. (formerly §1009(b)) *Form and venue of proceeding*

The form of a proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action, including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus, in a court of competent jurisdiction. Except to the extent that prior, adequate, and exclusive opportunity for judicial review is provided by law, agency action is subject to judicial review in civil or criminal proceedings for judicial enforcement.

§ 704. (formerly §1009(c)) *Actions reviewable*

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

§ 705. (formerly §1009(d)) *Relief pending review*

When an agency finds that justice so requires, it may postpone the effective date of action taken by it, pending judicial review. On such conditions as may be required and to the extent necessary to prevent irreparable injury, the reviewing court, including the court to which a case may be taken on appeal from or on application for certiorari or other writ to a reviewing court, may issue all necessary and appropriate process to postpone the effective date of an agency action or to preserve status or rights pending conclusion of the review proceedings.

§ 706. (formerly §1009(e)) *Scope of review*

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall--

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be--

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

Food, Drug and Cosmetic Act, 52 Stat 1055 (1938) as amended, 21 U.S.C. § 381, 371 and 334 (1966)

CHAPTER VIII--IMPORTS AND EXPORTS

Sec. 801 [381]. (a) The Secretary of the Treasury shall deliver to the Secretary of Health, Education, and Welfare, upon his request, samples of food, drugs, devices, and cosmetics which are being imported or offered for import into the United States, giving notice thereof to the owner or consignee, who may appear before the Secretary of Health, Education, and Welfare and have the right to introduce testimony. . . . . If it appears from the examination of such samples or otherwise that (1) such article has been manufactured, processed, or packed under insanitary conditions, or (2) such article is forbidden or restricted in sale in the country in which it was produced or from which it was exported, or (3) such article is adulterated, misbranded, or in violation of section 505, then such article shall be refused admission, except as provided in subsection (b) of this section. The Secretary of the Treasury shall cause the destruction of any such article refused admission unless such article is

exported, under regulations prescribed by the Secretary of the Treasury, within ninety days of the date of notice of such refusal or within such additional times as may be permitted pursuant to such regulations. . . .

(b) Pending decision as to the admission of an article being imported or offered for import, the Secretary of the Treasury may authorize delivery of such article of the owner or consignee upon the execution by him of a good and sufficient bond providing for the payment of such liquidated damages in the event of default as may be required pursuant to regulations of the Secretary of the Treasury. If it appears to the Secretary of Health, Education, and Welfare that an article included within the provisions of clause (3) of subsection (a) of this section can, by relabeling or other action, be brought into compliance with the Act or rendered other than a food, drug, device, or cosmetic, final determination as to admission of such article may be deferred and, upon filing of timely written application by the owner or consignee and the execution by him of a bond as provided in the preceding provisions of this subsection, the Secretary may, in accordance with regulations, authorize the applicant to perform such relabeling or other action specified in such authorization (including destruction or export of rejected articles or portions thereof, as may be specified in the Secretary's authorization). All such relabeling or other action pursuant to such authorization shall in accordance with regulations be under the supervision of an office or employee of the Department of Health, Education and Welfare designated by the Secretary, or an officer or employee of the Department of the Treasury designated by the Secretary of the Treasury.

CHAPTER VII--GENERAL ADMINISTRATIVE PROVISIONS

Regulations and Hearings

Sec. 701 [371]. (a) The authority to promulgate regulations for the efficient enforcement of this Act, except as otherwise provided in this section, is hereby vested in the Secretary.

(b) The Secretary of the Treasury and the Secretary of Health, Education, and Welfare shall jointly prescribe regulations for the efficient enforcement of the provisions of section 801, except as otherwise provided therein. Such regulations shall be promulgated in such

manner and take effect at such time, after due notice, as the Secretary of Health, Education, and Welfare shall determine.

(c) Hearings authorized or required by this Act shall be conducted by the Secretary or such officer or employee as he may designate for the purpose.

(d) The definitions and standards of identity promulgated in accordance with the provisions of this Act shall be effective for the purposes of the enforcement of this Act, notwithstanding such definitions and standards as may be contained in other laws of the United States and regulations promulgated thereunder.

(e)(1) Any action for the issuance, amendment, or repeal of any regulation under section 401, 403(j), 404(a), 406, 501(b), or 502(d) or (h) of this Act shall be begun by a proposal made (A) by the Secretary on his own initiative, or (B) by petition of any interested person, showing reasonable gounds therefor, filed with the Secretary. The Secretary shall publish such proposal and shall afford all interested persons an opportunity to present their views thereon, orally or in writing. . . . .

(f)(1) In a case of actual controversy as to the validity of any order under subsection (e), any person who will be adversely affected by such order if placed in effect may at any time prior to the ninetieth day after such order is issued file a petition with the Circuit Court of Appeals of the United States for the circuit wherein such person resides or has his principal place of business, for a judicial review of such order. . . .

(6) The remedies provided for in this subsection shall be in addition to and not in substitution for any other remedies provided by law.

(g) A certified copy of the transcript of the record and proceedings under subsection (e) shall be furnished by the Secretary to any interested party at his request, and payment of the costs thereof, and shall be admissible in any criminal libel for condemnation, exclusion of imports, or other proceeding arising under or in respect of this Act, irrespective of whether proceedings with respect to the order have previously been instituted or become final under subsection (f).

Sec. 304 [334] (Seizure provision)

(d)(1) . . . . If the article was imported into the United States and the person seeking its release establishes (A) that the adulteration, misbranding, or violation did not occur after the article was imported, and (B) that he had no cause for believing that it was adulterated, misbranded, or in violation before it was released from customs custody, the court may permit the article to be delivered to the owner for exportation in lieu of destruction upon a showing by the owner that all of the conditions of section 801(d) can and will be met: *Provided, however,* That the provisions of this sentence shall not apply where condemnation is based upon violation of section 402(a) (1), (2), or (6), section 501(a)(3), section 502(j), or section 601(a) or (d); *And provided further,* That where such exportation is made to the original foreign supplier, then clauses (1) and (2) of section 801(d) and the foregoing proviso shall not be applicable; and in all cases of exportation the bond shall be conditioned that the article shall not be sold or disposed of until the applicable conditions of section 801(d) have been met.

II

REGULATIONS

Regulations for the Enforcement of the Federal Food, Drug, and Cosmetic Act §§ 1.318-1.320, 20 Fed. Reg. 9539 (1955) as amended at 30 F.R. 5507 (1965); § 4.1(c), 20 Fed. Reg. 15285 (1964).

§ 1.318 *Hearing.*

(a) If it appears that the article may be subject to refusal of admission, the chief of district shall give the owner or consignee a written notice to that effect, stating the reasons therefor. The notice shall specify a place and a period of time during which the owner or consignee shall have an opportunity to introduce testimony. Upon timely request, giving reasonable grounds therefor, such time and place may be changed. Such testimony shall be confined to matters relevant to the admissibility of the article, and may be introduced orally or in writing.

(b) If such owner or consignee submits or indicates his intention to submit an application for authorization to relabel or perform other action to bring the article into compliance with the act or to render it other than a food, drug, device, or cosmetic, such testimony shall include evidence in support of such application. If such application is not submitted at or prior to the hearing, the chief of district shall specify a time limit, reasonable in the light of the circumstances, for filing such application.

§ 1.319 *Application for authorization.*

Application for authorization to relabel or perform other action to bring the article into compliance with the act or to render it other than a food, drug, device or cosmetic may be filed only by the owner or consignee, and shall:

(a) Contain detailed proposals for bringing the article into compliance with the act or rendering it other than a food, drug, device, or cosmetic.

(b) Specify the time and place where such operations will be carried out and the approximate time for their completion.

§ 1.320 *Granting of authorization.*

(a) When authorization contemplated by § 1.319 is granted, the chief of district shall notify the applicant in writing, specifying:

(1) The procedure to be followed;

(2) The disposition of the rejected articles or portions thereof;

(3) That the operations are to be carried out under the supervision of an officer of the Food and Drug Administration or the Bureau of Customs, as the case may be,

(4) A time limit, reasonable in the light of the circumstances, for completion of the operations; and

(5) Such other conditions as are necessary to maintain adequate supervision and control over the article.

(b) Upon receipt of a written request for extension of time to complete such operations, containing reasonable grounds therefor, the chief of district may grant such additional time as he deems necessary.

(c) An authorization may be amended upon a showing of reasonable grounds therefor and the filing of an amended application for authorization with the chief of district.

(d) If ownership of an article covered by an authorization changes before the operations specified in the authorization have been completed, the original owner will be held responsible, unless the new owner has executed a bond and obtained a new authorization. Any authorization granted under this section shall supersede and nullify any previously granted authorization with respect to the article.

§ 4.1 *Disclosure of official records and information.*

(c) A person who desires the disclosure of any such record or information may make written request therefor, verified by oath, directed to the Commissioner of Food and Drugs, setting forth his interest in the matter sought to be disclosed and specifically designating the use to which such records or information will be put in the event of compliance with such request. . . .

NO. 2 2 1 0 2

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HARRY SUGARMAN,

Appellant,

vs.

JACK B. FORBRAGD, et al.,

Appellees.

APPELLEES' BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

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APPELLEES' BRIEF

STATEMENT OF JURISDICTION

On March 31, 1967, appellant filed a Petition For Writ of Mandatory Injunction to compel employees of the Food and Drug Administration to admit certain fire-damaged coffee beans into this country unconditionally. [V. 1, pp. 1-5]. Appellant asserted that the District Court had jurisdiction under 28 U.S.C. 1361 and 5 U.S.C. 706 [formerly 1009(e)].

On May 15, 1967, the District Court filed an Order dismissing said Petition. [V. 1, p. 125]. In its Memorandum Opinion filed May 11, 1967, the District Court held

that it lacked jurisdiction over the subject matter. [V. 1, pp. 107-118]. The District Court further held that if it did have jurisdiction, it was convinced from its review of the case that the agency action complained of (refusing unconditional entry of the aforesaid damaged coffee beans) was not arbitrary or capricious, and that defendant would be entitled to a summary judgment. [V. 1, pp. 119-125].

On May 16, 1967, the District Court's Order of dismissal was entered. [V. 1, pp. 125-126]. On June 30, 1967, appellant filed a timely notice of appeal pursuant to 28 U.S.C. 2107. [V. 1, p. 127]. Appellant asserts that this Court's jurisdiction to review the judgment of the District Court rests upon 28 U.S.C. 1291.

We believe the holdings of the District Court are correct but we agree that this Court has jurisdiction under 28 U.S.C. 1291 to review such holdings.[1/]

1/ Appellant asserts that "this is an interlocutory appeal." [Appellant's Brief, p. 1]. We do not understand how this can be an interlocutory appeal when the District Court granted Respondents' Motion to Dismiss and in the alternative granted Respondents' Motion for Summary Judgment. [V. 1, p. 125]. See 28 U.S.C. 1292.

STATEMENT OF THE CASE

Appellant's "Statement of Proceedings Below" glosses over most of the significant facts and presents an unrealistic version of what happened. [Appellant's Brief, pp. 3-5].

The carefully considered Memorandum Opinion of the District Court, on the other hand, meticulously recites the underlying facts in this litigation. [V. 1, pp. 98-104; Sugarman v. Forbragd, 267 F. Supp. 817, 818-820]. We incorporate the District Court's "Statement of Facts" herein by reference.

All of the evidence in this case is in the form of documentary or physical exhibits. The Opinion of the District Court cites references to the exhibits upon which its "Statement of Facts" is based. Since the defendants' documentary exhibits have been repaginated on appeal, we have prepared the following tabulation for the convenience of the Court:

Defendants' Exhibits	Record on Appeal
1	V. 1, 47-56
1A	V. 1, 49; physical exhibit

Defendants' Exhibits	Record on Appeal
1B	V. 1, 50; physical exhibit
1C	V. 1, 51; physical exhibit
1D	V. 1, 52
1E	V. 1, 53
1F	V. 1, 54
1G	V. 1, 55
1H	V. 1, 56; physical exhibit
2	V. 1, 57
2A	V. 1, 58
2B	V. 1, 59-63
2C	V. 1, 64-65
2D	V. 1, 66-74
3	V. 1, 75
3A	V. 1, 76-85
4	V. 1, 86
5	V. 1, 87-88

Plaintiff's exhibits were not repaginated on appeal.

ARGUMENT

A. INTRODUCTORY STATEMENT

In its Memorandum Opinion, the District Court carefully considered every argument that was made by appellant in the proceeding below. We are wholly in accord with the reasoning and rulings of the District Court. We therefore incorporate the lower Court's Memorandum Opinion herein by reference. [V. 1, pp. 98, 107-124; 267 F. Supp. 817, 822-830].

Appellant now renews many arguments he made below and advances some arguments not made below. The rest of our brief will deal primarily with the latter arguments. We will also cite specific portions of the District Court's Memorandum Opinion where relevant.

B. AGENCY DETERMINATIONS REGARDING THE ADMISSIBILITY OF IMPORTS DO NOT REQUIRE A FORMAL HEARING OR AN "EXCLUSIVE RECORD FOR DECISION"

At the outset, we cite the relevant portion of the District Court's Memorandum Opinion. [V. 1, pp. 109-115; 267 F. Supp. 817, 823-826].

The statute in question, 21 U.S.C. 381(a), makes no provision for a formal hearing. An importer whose goods are detained when they are offered for entry into this country is given notice "and may appear before the Secretary of Health, Education, and Welfare and have the right to introduce testimony." As stated in The James J. Hill, 65 F. Supp. 265 (D. Md., 1946), at page 270:

> ". . . we are dealing with a subject matter of importation into the United States of articles where the power of Congress is absolute and the rights accorded the importer are only those given by the statute. The statute [section 381] accords a hearing only after notice to the importer with respect to the samples taken from the bulk of the commodity to determine whether it is properly importable. At the hearing upon notice the only right accorded to the importer is 'to introduce testimony.' Presumably this testimony should be relevant to whether the samples

are fairly illustrative of the bulk product, and if so whether the bulk product is properly importable."

[Emphasis added]

The informality of import proceedings provided by 21 U.S.C. 381(a) contrasts sharply with the formal administrative procedures specified in other provisions of the Federal Food, Drug, and Cosmetic Act. [V. 1, pp. 110-111; 267 F. Supp. at 824].

Appellant makes an elaborate web-spinning argument in an effort to show that Section 381(a) [2/] requires a formal hearing in which the agency action must be determined solely on the record of such hearing. [Appellant's Brief, pp. 30-36]. Appellant's purpose is to bring this proceeding within the scope of 5 U.S.C. 554(a) and 556(a) [3/] of the Administrative Procedure Act.

The short and decisive answer to this argument is that Section 381(a) speaks for itself. To read into it what appellant suggests calls for judicial legislation.

2/ Statutes are quoted in Appendix to Appellant's Brief.

3/ Same as footnote 2.

The Administrative Procedure Act does not superimpose the requirement of formal hearings in all administrative proceedings. It simply declares that where a statute requires an agency determination to be made "on the record" [5 U.S.C. 554(a)] then the procedural provisions of 5 U.S.C. 556(a) shall apply. Since Section 381(a) does not require agency determinations regarding imports to be made "on the record," appellant's argument is groundless. See Bridgeport Federal Savings and Loan Association v. Federal Home Loan Bank Board, 199 F. Supp. 410, 411-413 (E.D. Pa., 1961), aff'd 307 F. 2d 580, 581 (C.A. 3, 1962), cert. den. 371 U.S. 950, where it was held that the holding of an agency hearing did not require adherence to the procedural provisions of the APA, when neither the statute nor the regulations required the agency action"to be determined on the record after opportunity for an agency hearing." See also Appendix A of this brief for unreported opinion in another Food and Drug import case, Canadian Memorial Chiropractic College v. Shumate (W.D. N.Y., Civil 1966-189, July 26, 1967), where the Court stated on pages vi and vii:

"The statute gives the owner the right to introduce testimony. However, in the court's view, that right does not confer a right to a hearing as that term is ordinarily used, nor does the exercise of that right present a 'case of adjudication required by statute to be determined on the record after opportunity for an agency hearing' within the meaning of section 5 of the Administrative Procedure Act (5 U.S.C. §1004).

"In construing section 381, the broad power of Congress to regulate imports into the United States must be recognized. See Buttfield v. Stranahan, 192 U.S. 470 (1904); The Abby Dodge, 223 U.S. 166, 176-177 (1912). Unlike Wong Yong Sung v. McGrath, 339 U.S. 33 (1950), which is relied upon by plaintiff, the Constitution does not require a hearing to save this exercise of authority from invalidity."

To bolster his position, appellant presents a distorted view of Immigration and Deportation cases.

[Appellant's Brief, pp. 25-28]. A key point overlooked by appellant is stated in Leng May Ma v. Barber, 357 U.S. 185 (1958) at page 187:

> "It is important to note at the outset that our immigration laws have long made a distinction between those aliens who have come to our shores seeking admission, such as petitioner, and those who are within the United States after an entry, irrespective of its legality. In the latter instance, the Court has recognized additional rights and privileges not extended to those in the former category who are merely 'on the threshhold of initial entry.'"
>
> [Emphasis added]

An earlier decision emphasized the significance of this distinction. Shaughnessy v. U. S. ex rel. Mezei, 345 U.S. 206 (1953), where the Court said at page 212:

> "It is true that aliens who have once passed through our gates, even illegally, may be expelled only after proceedings conforming to traditional standards of fairness

encompassed in due process of law. . . . [citing cases including Wong Yang Sung v. McGrath, 339 U.S. 33]. But an alien on the threshhold of initial entry stands on a different footing: 'Whatever the procedure authorized by Congress is, it is due process as far as an alien entry is concerned.' . . . And because the action of the executive officer under such authority is final and conclusive, the Attorney General cannot be compelled to disclose the evidence underlying his determinations in an exclusion case; 'it is not within the province of any court, unless expressly authorized by law, to review the determination of the political branch of the Government.' . . . In a case such as this, courts cannot retry the determination of the Attorney General."

[Emphasis added]

Affirming a decision of this Court in a suspension of deportation proceeding, the Supreme Court said in Jay v. Boyd, 351 U.S. 345 (1956) at page 353:

"But there is nothing in the language of § 244 of the Act upon which to base a belief that the Attorney General is required to give a hearing with all the evidence spread upon an open record with respect to the considerations which may bear upon his grant or denial of an application for suspension to an alien eligible for that relief."

The analogy between the Immigration cases and the instant appeal is manifest. Here we have fire-damaged coffee beans which are at the threshhold of entry into the United States. The salvage operator who purchased them "as is" and "reconditioned" them has no constitutional right to a hearing "on the record" any more than has an alien seeking entry into the country. Buttfield v. Stranahan, 192 U.S. 470, 497 (1903). His only rights are those expressly conferred by 21 U.S.C. 381(a), namely, to receive "notice" and to "have the right to introduce testimony." He is given no right to require the agency to spell out the basis for its action "on the record," though in fact appellant was informed of the agency's views in advance of his opportunity "to introduce testimony." [Plaintiff's Exhibits A, C, F].

The analogy between food and drug cases and Immigration cases goes further. Once a food or drug is formally permitted entry into the country, it loses its import status under 21 U.S.C. 381(a). If it develops thereafter that the article is in violation of the adulteration, misbranding, or other provisions of the statute, the product may not be ordered to be destroyed or reexported by administrative action alone. Under such circumstances, there must be a judicial proceeding for condemnation under 21 U.S.C. 334(a) and (b), with a right to a jury trial. See 230 Boxes . . . of Fish v. U. S., 168 F. 2d 361, 364 (C.A. 6, 1948).

From the foregoing, it is manifest that appellant's argument relating to Wong Yang Sung v. McGrath, 339 U.S. 33 (1950)--[see Appellant's Brief, pp. 25-28]--gives misplaced emphasis to its significance since that case dealt with deportation rather than exclusion proceedings. See also Kwong Hai Chew v. Colding, 344 U.S. 590 (1953), especially footnotes 4 and 5 at page 596. The Immigration case which is in point here and which we have already discussed is Shaughnessy v. U. S. ex rel. Mezei, 345 U.S. 206, 212 (1953).

C. AGENCY DETERMINATIONS REGARDING THE ADMISSIBILITY OF IMPORTS ARE COMMITTED TO AGENCY DISCRETION BY LAW

At the outset, we cite the relevant portion of the District Court's Memorandum Opinion which considered and rejected most of the arguments offered on appeal by appellant. [V. 1, pp. 107-113; 267 F. Supp. 817, 822-825]. The District Court concluded that agency action in this case is "committed to agency discretion by law." For this reason, judicial review under the Administrative Procedure Act is precluded by the exception in 5 U.S.C. 701(a)(2).

Congress has plenary power with respect to imports. In 21 U.S.C. 381(a), it directed the Secretary to refuse admission of an import--

> "if it appears from the examination of such samples or otherwise that (1) such article has been manufactured, processed, or packed under insanitary conditions, or (2) such article is forbidden or restricted in sale in the country in which it was produced or from which it was exported, or (3) such article

is adulterated, misbranded, or in violation of section 355 of this title . . ."

Agency action is to be predicated upon the appearance of any of the three specified conditions, and such appearance in turn may derive from "the examination of such samples or otherwise." The agency is vested with the broadest possible discretion to keep out of the country foods, drugs, devices, and cosmetics which appear to be in violation of the Federal Food, Drug, and Cosmetic Act of this country, or the laws of the countries where they are produced or from which they are exported. The grounds for agency action may be obtained from foreign as well as domestic sources.

Congress deliberately chose a procedure that would commit discretion to the agency by law to act expeditiously with respect to the vast quantities of imports in this field. It conferred limited rights upon the importer to receive notice and "to introduce testimony" so that the agency would have an opportunity to evaluate the importer's views before reaching a final decision.

But Section 381(a) does not require the agency "to introduce testimony" nor does it state that the agency

determination must be based solely on a record of testimony introduced at a hearing. On the contrary, the language of the statute gives the agency unfettered authority to make its determination on information obtained from an examination of the sample or otherwise. Moreover, the statute does not permit judicial review of import determinations though, as shown earlier, judicial review is expressly authorized by the same Act with respect to many other agency actions. [V. 1, pp. 110-111; 267 F. Supp. at 824].

Here again, as in Section B of this argument, the Immigration cases are most closely analogous with respect to the reviewability of agency action under the Administrative Procedure Act. In Montgomery v. Ffrench, 299 F. 2d 730 (C.A. 8, 1962), the statute provided that an alien child could be admitted on a non-quota basis if the Attorney General was satisfied that the U. S. citizen, who had adopted the child by proxy and wished to bring the child here, had the ability to care for the child properly. The agency decision was to be made on petition of the citizen, and an "investigation of the facts" stated in the petition. The agency decision denying the petition

was held to be "agency action committed to agency discretion" and not reviewable under the Administrative Procedure Act. On page 734, the Court noted the distinction between exclusion and deportation cases, and stated:

> ". . . admission of an alien to this country is not a right but a privilege which is granted only upon such terms as the United States prescribes."

Also on page 734, the Court quoted from Brownell v. Tom We Shung, 352 U.S. 180, 182 (1956):

> ". . . in exclusion cases involving initial entry 'the decisions of executive or administrative officers, acting within powers expressly conferred by Congress, are due process of law.'"

The sole procedural distinction between Montgomery and the case at bar is that Montgomery presented his views in writing whereas Sugarman presented his views both orally and in writing. In both cases, the statutes delegated to the respective agencies complete discretion to investigate and evaluate the facts and make a final determination in

no way bound to a "record." Both cases involved "initial entry" into this country where the power of Congress is plenary and constitutional due process is not involved.

We believe it would take a strong showing of express Congressional intent to establish that agency action permitting conditional entry of fire-damaged coffee beans is reviewable under the Administrative Procedure Act, while agency action excluding an alien orphan and denying the petition of the child's adopted parents is not reviewable under that Act. See also Angelis v. Bouchard, 181 F. Supp. 551, 557 (D. N.J., 1960).

Using imprecise terminology and confusing various types of administrative procedures provided by the Federal Food, Drug, and Cosmetic Act, appellant mistakenly relies upon two recent Supreme Court decisions, Abbott Laboratories v. Gardner, 387 U.S. 136 (1967), and Toilet Goods Assn., Inc. v. Gardner, 387 U.S. 158 (1967). [Appellant's Brief, pp. 9-14, 20-21, 48-49].

The Abbott case arose out of legislation declaring a prescription drug to be misbranded unless its label

and labeling bear the "established" name of the drug printed prominently and in type at least half as large as the proprietary name or designation of the drug. [See pages 137-138]. By regulation, the Commissioner of Food and Drugs interpreted this statute to require the "established" name to accompany each appearance of the proprietary name or designation. The regulation simply gave the affected industry advance notice as to how the Commissioner intended to administer this law.

The regulation could only be enforced in a judicial proceeding--namely, through injunction, criminal, or seizure action, in which the United States would allege that a specific prescription drug was misbranded because the established name did not accompany each appearance of the proprietary name or designation. [21 U.S.C. 331(a), 332(a), 333(a), 334(a), 352(e)(1)(B)]. The key point is that ultimately the validity of this regulation would have to be tested in a judicial enforcement proceeding brought by the United States. [21 U.S.C. 337]. The question in Abbott was whether the case was ripe for judicial review in a pre-enforcement declaratory judgment proceeding brought by the manufacturers of more

than 90 per cent of the nation's prescription drugs. [See pages 138-139].

The Court noted that there is a pre-enforcement statutory review proceeding with respect to other types of food and drug regulations. [See pages 144-146]. The Court held that pre-enforcement judicial review of this regulation was not precluded by the statute, and that the case was in fact "ripe" for judicial resolution under the Declaratory Judgment Act and the Administrative Procedure Act. [See pages 148-153].

In the companion case of Toilet Goods Assn. v. Gardner, 387 U.S. 158 (1967), the validity of a different interpretive regulation was involved. There the Court held that pre-enforcement judicial review was inappropriate at that stage because the controversy was not yet ripe for adjudication.

Abbott and Toilet Goods Assn. concerned interpretive regulations affecting entire industries. The present appeal concerns a determination as to the admissibility of one lot of fire-damaged coffee beans which appellant

purchased for $600 "as is." 4/ The statute contemplates that interpretive regulations can be enforced only in a judicial proceeding, so that the issue in Abbott and Toilet Goods Assn. was not whether there should be a judicial proceeding to test the validity of the regulation, but when a judicial proceeding would be appropriate. On the other hand, the import statute contemplates no judicial proceeding whatsoever to review an agency determination made under that statute. [21 U.S.C. 381(a)].

In short, Abbott and Toilet Goods Assn. have no bearing on the applicability of the judicial review

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4/ Appellant seeks to raise the importance of this case to the Abbott level. On page 53 of his brief, he says:

> "The entire import industry dealing with foods, drugs, and cosmetics will be affected by this decision."

In Abbott, the petitioners included the manufacturers of more than 90% of the nation's supply of prescription drugs. [387 U.S. at 138-139]. In the present case, there is no hue and cry by the "import industry." Sugarman represents only himself and his joint venturers in this single salvage operation. [V. 1, pp. 87-88].

provisions of the Administrative Procedure Act to agency determinations under 21 U.S.C. 381(a). 5/

Concluding that the agency action in question was exempt from the Administrative Procedure Act and not subject to judicial review, the lower court appropriately held that it lacked jurisdiction and that the Petition should be dismissed.

D. THE DISTRICT COURT PROPERLY HELD THAT THE AGENCY ACTION WAS NEITHER ARBITRARY NOR CAPRICIOUS, AND THAT RESPONDENTS WERE ENTITLED TO SUMMARY JUDGMENT

After dismissing the Petition, the District Court nevertheless went on to examine appellant's assertion that the agency action was arbitrary and capricious. The Court declared that if its Order of dismissal should be found to be in error, it had reviewed the agency action

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5/ We do not attempt to refute every erroneous or misleading statement in appellant's brief. For example, on page 9, appellant declares that Abbott and Toilet Goods Assn. "held that the FDA must follow APA procedures in promulgating regulations." This was simply not the holding of those cases.

for reasonableness and had concluded that such action was not arbitrary or capricious. [V. 1, pp. 119-122; 267 F. Supp. 828-829]. It further held that respondents would then be entitled to a summary judgment. [V. 1, pp. 122-123; 267 F. Supp. 829-830].

As stated earlier, we adopt all of the reasoning of the lower Court in its Memorandum Opinion.

The lower Court noted that two earlier cases had considered agency action with respect to imports to be judicially reviewable to determine whether such action is arbitrary or capricious. Ambruster v. Mellon, 41 F. 2d 430 (Apps. D.C., 1930) and The James J. Hill, 65 F. Supp. 265 (D. Md., 1946).

Appellant mistakenly contends these cases stand for the proposition that there should be a trial de novo in the District Court regarding agency import actions. [Appellant's Brief, pp. 48-49]. In the Ambruster case, the plaintiff, a distributor of ergot of rye, sought to enjoin the agency from admitting competitive products into the country. Dismissal of the complaint was affirmed because the complaint (1) showed the agency had authority to act, and (2) failed to allege facts from which it

could be inferred that the agency action was arbitrary or capricious. There is no suggestion of a trial de novo in that case.

In The James J. Hill, the District Court took testimony on the admissibility of an import, but only for the purpose of determining whether the agency action was arbitrary or capricious, not to hold a trial de novo.

We believe the lower Court in the present case was correct when it stated:

> 267 F. Supp. 828:
>
> "The Court is satisfied that a broad inquiry into whether this agency action is 'arbitrary or capricious' is outside the jurisdiction of the Court. The only permissible inquiry is whether the statute is constitutional and whether the respondents acted within the scope of their statutory authority in reaching a decision . . . See Larson . . ." 6/

6/ This principle was recognized in The James J. Hill, 65 F. Supp. 265 (D. Md., 1946), where the Court noted at page 270:

> ". . . it is clear that in the present case the statute makes no provision for (Continued)

Nevertheless, the lower Court went on to review the voluminous record of documents and physical exhibits and concluded that the agency action was not arbitrary or capricious. We respectfully ask this Court to examine the lower Court's detailed exposition of the basis for its conclusion. [V. 1, pp. 119-122; 267 F. Supp. 828-829].

The Court further held that if it did have jurisdiction to consider both motions for summary judgment, the respondents were entitled to a summary judgment. [V. 1, pp. 122-123; 267 F. Supp. 829-830].

As the Court pointed out, "the only issue at this stage would be whether 'it appears from examination of

---

6/ (Continued) judicial review and creates no personal federal rights as the basis for judicial review, so long as the Secretary acted within the scope of his authority under the Act."

[Emphasis added]

Thus the District Court in Hill properly stated the legal principle but improperly applied it by embarking on an inquiry as to whether the agency action was arbitrary or capricious. We believe the proper limits of a court inquiry are those defined in Larson v. Domestic and Foreign Commerce Corp., 337 U.S. 682, 689-690 (1949), and applied by the lower Court in the present case. [V. 1, pp. 115-117; 267 F. Supp. at 826-827].

* * * samples or otherwise that * * * such article is adulterated.' [21 U.S.C. 381(a)]." The evidence was uncontroverted that the charred coffee beans "appear" to be adulterated within the meaning of 21 U.S.C. 342(a)(3) in that they "appear" to be unfit for food.

A laboratory analysis was made of a sample of 12 pounds of these coffee beans. All of the beans were black on the surface. Six beans were cut in half, showing black color throughout the beans in all cases. The black beans left a black residue on the hands after examination. [V. 1, p. 53].

Another analysis consisted of (1) grinding the black coffee beans "as is," and brewing a beverage, and (2) roasting and grinding the black coffee beans and brewing a beverage. The first beverage had a slight smoky odor and flavor and a very slight odor and flavor of green coffee. The second beverage was nearly devoid of any coffee flavor and had a toasted flavor. Its color was very light, similar to light black tea beverage. [V. 1, p. 54].

The Court also had before it specimens of these charred coffee beans, unroasted and roasted [Defendants'

Exhibits 1A and 1H], as well as specimens of normal green coffee beans and normal roasted coffee beans. [Defendants' Exhibits 1B and 1C]. In addition, the Court had a comprehensive record of the manner in which these beans were damaged by fire, sea water, and smoke. [V. 1, pp. 98-101; 267 F. Supp. 818-819].

Petitioner did not refute these facts. He contended that an acceptable drink would result if these charred beans were "blended" with Brazilian coffee beans in the proportion of 10% to 90%, although the blending expert who testified for petitioner stated [Petitioner's Exhibit I-1, pp. 29, 30-37]:

> "In this case, this particular coffee with its changed profile, represented a, one might say, challenge."
>
> [Emphasis added]

After quoting this statement, the District Court commented [V. 1, pp. 121-122; 267 F. Supp. 829]:

> "This is a remarkable circumlocution and understatement, since the real issue was how to disguise these damaged beans through a blend and grind with normal

coffee beans so that the public might think the finished product is coffee."

Citing Federal Security Administrator v. Quaker Oats Co., 318 U.S. 218 (1943), for the principle that a major objective of the Food and Drug law is to preserve the integrity of the food supply and protect the consumer from economic adulteration, the Court continued:

> "Petitioner's proposal to blend the charred coffee beans with normal coffee beans is in reality a proposal to adulterate the good coffee beans, by substituting in part a cheapened and worthless commodity for genuine coffee beans. It is as though the proposal were to make a blend of used coffee grounds with freshly ground coffee. No doubt a skillful 'blending' of the charred coffee beans with genuine coffee beans, or of used coffee grounds with freshly ground coffee, would enable a coffee producer to palm off the finished product on an unsuspecting public as coffee.'"

Clearly, the charred coffee beans had the appearance of being adulterated since they were practically devoid of the characteristics of normal coffee. Thus the respondents were entitled to a summary judgment if the District Court had jurisdiction to reach that question.

E. THIS IS AN UNCONSENTED SUIT AGAINST THE UNITED STATES

Nominally this is a suit against two individuals. However, the suit is against those two individuals acting in a representative capacity as officers of the Government. Moreover, the suit seeks to compel the Government to take certain affirmative action--namely, to admit fire-damaged coffee beans into the country without the conditions heretofore imposed.

Unless the United States has expressly consented to be so sued, this is an unconsented suit against the sovereign, where the scope of judicial review is extremely limited. The leading case on this point is Larson v. Domestic and Foreign Commerce Corp., 337 U.S. 682 (1949),

which was carefully considered in the Memorandum Opinion of the District Court. [V. 1, pp. 115-118; 267 F. Supp. 826-828].

We maintain that this is an unconsented suit against the sovereign since, as we have already shown, (1) the import statute [21 U.S.C. 381(a)] does not provide for judicial review of agency determinations thereunder; (2) the Administrative Procedure Act [2 U.S.C. 706] does not provide for judicial review of such agency determinations because the challenged agency action is committed to agency discretion by law and is exempt from the APA by 5 U.S.C. 701(a)(2); and (3) other portions of the Administrative Procedure Act [5 U.S.C. 556(a) and 554(a)] are not applicable because neither the import statute [21 U.S.C. 381(a)] nor the Constitution requires such agency action "to be determined on the record after opportunity for an agency hearing."

Consequently, the only proper judicial review is that described in the Larson case, supra, as delineated in the Memorandum Opinion of the District Court, supra,--i.e., is the statute unconstitutional or were the officers' actions outside the statutory limitation of their powers?

As pointed out in footnote 4 of the Memorandum Opinion:

267 F. Supp. 827:

"For the Court to have jurisdiction, the action must be ultra vires the officer's authority. 'A claim of error in the exercise of that power is therefore not sufficient.' 337 U.S. at page 690, 69 S. Ct. at page 1461."

The lower Court properly concluded that it lacked jurisdiction to review the agency action since such action was well within the statutory authorization to act and there was no challenge of the statute's constitutionality. For these reasons, it dismissed the Petition.

CONCLUSION

Appellant's brief offers a welter of arguments which, on close examination, are without substance. As this Court observed in another food and drug case, Pasadena Research Laboratories, Inc. v. U. S., 169 F. 2d 375, 379 (C.A. 9, 1948), cert. den. 335 U.S. 853:

". . . we are here being asked to accept . . . refinements that we believe are as gossamer-like as the traditional 'shadow of a shade' of the ancient legal commentators."

We submit that the judgment of the District Court should be affirmed.

DATED: March 15, 1968.

Respectfully submitted,

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CERTIFICATIONS

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ROBERT N. ENSIGN
Assistant United States Attorney

This is to certify that I have this date sent three copies of this brief by certified mail to counsel for Appellant addressed as follows:

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DATED: March _____, 1968.

ROBERT N. ENSIGN
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APPENDIX A

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF NEW YORK

CANADIAN MEMORIAL CHIROPRACTIC COLLEGE,

Plaintiff

-vs- CIVIL 1966-189

MERVIN H. SHUMATE, Food and Drug Officer, Food and Drug Administration, Buffalo District, Department of Health, Education and Welfare, et al.,

Defendants.

DECISION

Henderson, District Judge

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF NEW YORK

CANADIAN MEMORIAL CHIROPRACTIC COLLEGE,

Plaintiff

-vs- CIVIL 1966-189

MERVIN H. SHUMATE, Food and Drug Officer, Food and Drug Administration, Buffalo District, Department of Health, Education and Welfare, et al.,

Defendants

Bass and Friend (Solomon H. Friend, Esq., of Counsel), New York, New York, Attorneys for Plaintiff.

John T. Curtin, Esq., United States Attorney (C. Donald O'Connor, Esq., of Counsel), for the Defendants.

The Food and Drug Administration has issued an order requiring that five synchro-therme skin temperature measurement devices, heretofore provisionally entered for importation into the United States, be exported or destroyed. The plaintiff, owner of the devices, has commenced this action claiming that the defendants acted beyond the scope of their authority, that the order is not

based upon any evidence, and that the order resulted from an unfair hearing not held in conformity with the Administrative Procedure Act (5 U.S.C. 1001 et seq.). The Government moves to dismiss the complaint or for summary judgment.

In his affidavit in opposition to the Government's motion, Andrew R. Petersen, the inventor of the device in question, describes the device as follows:

> "The Synchro-Therme device is not used to treat, cure or prevent any diseases or conditions in man. It is simply a temperature measurement device which is intended to measure the differential in temperature of two points on the surface of the skin of a human back in the vicinity of the spine. It measures the temperature in two places with two separate and distinct sensors, displaying these measure temperatures on adjacent scales for convenient comparison. These temperature readings are utilized by licensed practitioners as part of the examination of a patient, in the same sense that a stethoscope or an oral or rectal thermometer is used to examine a patient preparatory to a diagnosis which will enable the physician to prescribe an appropriate form of treatment. Based upon my experience in the use of the device and my discussions with numerous licensed practitioners who utilize the device, the directions accompanying the device are adequate, proper and complete to enable the practitioner to use the device for such purposes.

* * * *

"In this connection, I categorically and unequivocally state that the use of the Synchro-Therme by licensed practitioners to measure skin temperature gradients on the surface of the back is safe and that there is not even the remotest possibility that the device can have any untoward effect when used by licensed practitioners for such purposes.

"I wish to further inform this Court that this device has never been advertised to the lay public and has never been sold or leased to any member of the lay public. The fact of the matter is that the devices are provided only to duly licensed practitioners on a rental or lease basis and that plaintiff exerts full and complete control over the distribution thereof by reason of the periodic servicing and calibration requirements contained in each such lease."

For the purposes of these motions, the court, without deciding, will assume these statements are fact and will further assume that these facts were satisfactorily established in testimony before officials of the Food and Drug Administration. It is noted, however, that having acknowledged the device to be an aid to diagnosis, the plaintiff has assiduously avoided answering what significance its findings may have to a licensed chiropractor.

Section 381, Title 28 U.S.C. provides in pertinent part:

"(a) The Secretary of the Treasury shall deliver to the Secretary of Health, Education

and Welfare, upon his request, samples of . . . devices . . . which are being imported or offered for import into the United States, giving notice thereof to the owner or consignee, who may appear before the Secretary of Health, Education and Welfare and have the right to introduce testimony. . . . if it appears from the examination of such samples or otherwise that . . . (3) such article is . . . mislabeled . . . then such article shall be refused admission. . . ."

A device is mislabeled "[u]nless its labeling bears . . . adequate directions for use . . ." 21 U.S.C. § 352. The term "adequate directions for use" is defined in pertinent part by 21 C.F.R. § 1.106 as follows:

> "(a) Adequate directions for use. Adequate directions for use means directions under which the layman can use a drug or device safely and for the purposes for which it is intended. Directions for use may be inadequate because (among other reasons) of omission, in whole or in part, or incorrect specification of:
>
> (1) Statements of all conditions, purposes, or uses for which such drug or device is intended, including conditions, purposes or uses for which it is prescribed, recommended, or suggested in its oral, written, printed, or graphic advertising, and conditions, purposes, or uses for which the drug or device is commonly used; except that such statements shall not refer to conditions, uses, or purposes for which the drug or device can be safely used only under the supervision of a practitioner licensed by law and for which it is advertised solely to such practitioner."
>
> [Emphasis added.[

In the court's view, the statute and regulation in question are sufficiently broad to require a satisfactory showing that the device is neither a fraud nor, though a bona fide diagnostic aid, a device presenting findings requiring interpretations which are beyond the professional competence of licensed chiropractors. That the device, in and of itself, may be harmless does not end proper inquiry.[1]

The plaintiff argues that since the defendants have failed to show that the device is not completely safe when used by licensed chiropractors, the Government's motion must be denied. This argument misapprehends its burden under section 381.

The statute gives the owner the right to introduce testimony. However, in the court's view, that right does not confer a right to a hearing as that term is ordinarily used, nor does the exercise of that right present a "case of adjudication required by statute to be determined on the record after opportunity for an agency hearing" within the meaning of section 5 of the Administrative Procedure Act (5 U.S.C. § 1004).

---

1. Cf. Drown v. United States, 198 F. 2d 999, 1006 (9th Cir. 1952).

In construing section 381, the broad power of Congress to regulate imports into the United States must be recognized. See Buttfield v. Stranahan, 192 U.S. 470 (1904); The Abby Dodge, 223 U.S. 166, 176-177 (1912). Unlike Wong Yong Sung v. McGrath, 339 U.S. 33 (1950), which is relied upon by plaintiff, the Constitution does not require a hearing to save this exercise of authority from invalidity.

The decision in this type of case often will turn solely upon the Administration's examination of the article or device. Unless it is apparent, as it was not in this case, that an article or device is properly labeled, facts demonstrating the propriety or impropriety of the labeling, or facts bringing the article within an exception contained in the regulations, although known to or obtainable by the owner or consignee, may well be unavailable to the Government. Administrative action, therefore, often may not be grounded upon the record of testimony offered by the owner or consignee but instead will be based upon its examination of the articles or devices involved.

Thus, recognizing the hardship under which the Government must operate, the statute quite logically does not hinge administrative action upon the outcome of an agency hearing but merely grants the owner or consignee a right to present testimony bearing on the admissibility of the goods. This is not to say, of course, that the Administration may arbitrarily refuse entry of articles or devices once all reasonable objection to their entry has been removed by evidence presented by the owner or consignee.

As previously indicated, the court is satisfied from the plaintiff's own view of its evidence that it failed to carry its burden in this case. Accordingly, the Government's motion for summary judgment is granted. This disposition, however, should not be taken as an endorsement of the Government's refusal to permit transcription of the proceedings involved. The net effect of this ruling is to presently permit the plaintiff to export its devices. If it wishes, it may again offer the devices for import and it may offer such additional and further testimony as it deems necessary to support their entry. A remand is not in order inasmuch as it

would give the plaintiff a further opportunity to meet deficiencies in its proof which is not envisioned by the statute.

Submit judgment.

/s/ John O. Henderson
JOHN O. HENDERSON
United States District Judge

DATED: July 26, 1967.

No. 22,102

22102

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HARRY SUGARMAN,

Appellant,

vs.

JACK B. FORBRAGD, et al.,

Appellee.

APPELLANT'S REPLY BRIEF

Appeal to Review Judgment of the
United States District Court for
the Northern District of California

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FILED

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IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HARRY SUGARMAN, *Appellant,* vs. JACK B. FORBRAGD, et al., *Appellee.*	]	No. 22,102

APPELLANT'S REPLY BRIEF

A. INTRODUCTORY STATEMENT

With the exception of a few pages the appellee's brief consists of restatement and affirmation of previously advanced positions, rather than a rebuttal of points made in the appellant's opening brief. By discounting arguments as "web-spinning," the appellee avoids the necessity of answering them. Instead the government reiterates its original stand, acceptance of which requires the Court to give judicial blessing to the Food and Drug Administration's exercise of unrestrained authority in the regulation of imports.

The appellant offers the following answers to the positions taken by the appellee.

B. AGENCY DETERMINATIONS REGARDING THE ADMISSIBILITY OF IMPORTS DO REQUIRE THE HOLDING OF A FAIR HEARING IN ACCORDANCE WITH THE ADMINISTRATIVE PROCEDURE ACT.

1. The appellee does not respond to most of the appellant's arguments.

The essential idea of the APA is to provide fair and uniform procedures for the use of federal administrative agencies; it is comparable to a general procedural statute such as the Federal Rules of Civil Procedure. APA provides for basic procedural rights, which should be available to all citizens, regardless of the agency with which they are dealing. Administrative hearings, an important aspect of the process by which the government exercises its power, are by law held according to the procedures of the APA where the specific statute giving jurisdiction to the agency makes provision for a hearing. The appellee would deny all such procedural safeguards, painstakingly constructed by Congress, to any citizen involved in importing goods under the jurisdiction of the Federal Food and Drug Act. The reason for the denial is the absence of the specific word "hearing" in Section 381 (21 *U.S.C.* 381).

The appellee maintains that FDC import provisions, in failing to specify that a fair hearing is required, speak for themselves. The appellant believes that the government has listened only in a very superficial manner. It has refused

to consider universally-accepted rules of statutory construction as a means of ascertaining the meaning and intent of the passage (see pp. 30-36 of appellant's opening brief). It has failed to come to grips with the fact that, in spite of the absence of the *word* "hearing," *all the elements of a hearing are provided for* within the FDC Act import provisions as follows:

1. "notice...to the owner or consignee"
   21 *U.S.C.* 381(a)

2. an opportunity to "appear before the Secretary of Health, Education, and Welfare"
   21 *U.S.C.* 381(a)

3. a "right to introduce testimony"
   21 *U.S.C* 381(a)

4. a right to introduce a record from hearings examining the reasonableness of regulations affecting the admissibility of imports.
   21 *U.S.C.* 371(g)

The government has neglected to furnish the Court with any explanation as to why the FDA itself ascribes to these enumerated rights the term "hearing" when routinely making use of a form entitled "Notice of Detention and Hearing" in dealing with imports.[1] Moreover, the government fails to comment upon the emptiness and idleness of a procedure which, if interpreted as it desires, represents no more than a "wailing wall" at which the citizen supposedly can express his frustrations.

---

1. In actual practice the FDA makes informal records of the import hearings which are sent to Washington, D. C. for review and consideration by officials unknown to appellant (Plaintiff's Exhibit "I-1" pages 53-54).

2. *Wong* shows that the Court will waive the requirements that a "hearing" be expressly provided for in order to apply the APA.

The one argument concerning fair hearings to which the appellee did respond concerned *Wong Yang Sung vs. McGrath*, 339 U.S. 33 (1950) (See opening brief, pp. 25-28). The response included a labelling of the appellant's view of immigration and deportation cases as "distorted." Here the respondent would seem to have overlooked the purpose for which the appellant directed the court's attention to the deportation cases, and to have demonstrated a lack of understanding of appellant's position. The decisions in question were introduced to illustrate instances in which the Supreme Court has disregarded formal and technical requisites for the application of the APA provision to agency hearings. The appellant contended and still contends that, even if the court should interpret Section 381(a) as not formally calling for a hearing, the provisions of APA would still be applicable in view of such decisions as that in the *Wong* case.

As pointed out in appellant's brief, the Supreme Court has come to the conclusion that, in instances where procedural due process compels a fair hearing, such hearing must be granted under the provisions of APA. In the *Wong* case it was decided that a hearing was mandatory in order to protect and preserve the rights of an individual in accordance with the most fundamental tenets of the U.S. Constitution. In

the instant case again we are faced with the violation of the rights of an individual, in that the FDA is attempting to decide upon a matter without giving the individual an opportunity to present his case at a fair hearing, conducted in accordance with the standards of the APA.

The respondents contend and would have this court conclude that the coffee in question was "on the threshold of entry into the United States," and that, consequently, those decisions dealing with immigration cases and the principles announced therein should be controlling. A cursory inspection of this premise reveals its erroneous nature. We are speaking, in the instant case, of property rights of individuals who are citizens of the United States; we are speaking of the property rights of persons, not of coffee beans. We are speaking of the rights of those individuals who are afforded the protection of our laws to their property, and not the right of a sack of coffee beans or a carload of bananas to enter the United States.

3. Where APA safeguards are not applied, abuse of authority can result.

Why does the government attempt to avoid the fair hearing procedures of the APA in the area of import regulations? Certainly it is more convenient for the agency not to have to comply with these safeguards.[2] But isn't greater assurance

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2. *Goldhaft vs. Larrick*, Civ. No. 122-62, D, N.J., Aug. 20,
(Continued on page 6)

of just results more important than convenience? Unrestrained authority in the hands of any government agency, even if wisely used in the majority of cases, is always a danger in that it can be misused. A recent case would seem to illustrate this problem. This case also indicates that the courts have not always bowed before the FDA's claim of absolute discretion over the control of imports, a point to be developed presently.

In *Carl Borchsenius Co. Inc. vs. John W. Gardner, et al.*, (E.D. La., New Orleans Div., Civil [illegible]-321, March 15, 1968) the facts were as follows. A shipment of 3,301 bags of coffee arrived in New Orleans. A wharf examination by a United States Food and Drug Inspector disclosed that half the bags of coffee were damaged by contact with water. 1,325 bags were sound and released for entry into the United States. Remaining bags were received for reconditioning by a salvor. Of these 1,730 bags were made sound and thus brought into compliance with the law, and 1,053 bags were not reconditioned due to mold.

---

2. (Continued from page 5) 196- (unreported) is one illustration of the FDA's tendency to avoid APA "complications" where possible. Here the government, in acting on a New Drug Application, asserted that it was exempt from adjudication requirements of the APA on the basis that its "decisions rest solely on inspections, test, or election". 5 U.S.C. §554(a)(5). The District Court held that a "formal, adversary hearing, involving the issue of whether New Drug Authorizations should be continued in force or suspended" was not one to which the exemption was meant to apply. The revocation order was reversed and remanded for a decision made in accord with the APA.

The FDA arbitrarily withheld permission for entry into the United States of the 1,730 bags of sound coffee beans until the owner agreed that the 1,053 bags of the damaged beans be destroyed rather than re-exported. The government argued that Section 801(b) deprived an owner of the choice under Section 801(a) to re-export the rejected coffee beans, and that the District Court had no jurisdiction since the agency was acting within its discretionary authority. The District Court found the FDA was acting beyond its statutory authority and enforced a mandantory injunction requiring the government to release the rejected coffee beans for re-exportation and the sound coffee beans for entry into the United States.

C. JUDICIAL REVIEW IS AVAILABLE IN THE PRESENT CASE BECAUSE THE FDA EXCEEDED ITS STATUTORY LIMITS OF AUTHORITY.

1. Again, appellee either fails to answer or misconstrues appellant's previous arguments.

The appellee's answering brief commences its argument concerning the availability of judicial review, which hinges upon the degree and type of discretion possessed by the FDA, by citing the District Court's opinion "which considered and rejected most of the arguments offered on appeal by appellant." (See appellee's answering brief, p. 14.) In order to set the record straight, the appellant points out that a substantial portion of his opening brief's statements on this subject (pp. 8-21) concerned the decision in *Abbott Laboratories v.*

Gardner, 387 U.S. 136 (1967), which was not yet in existence when the present case was decided in the lower court. Nor can the District Court be said to have rejected the arguments of the authorities cited by the appellant, Davis and Jaffe, since it did not mention them. Moreover, the court did not deal with the opening brief's points regarding the implications on the availability of judicial review of the FDC Act's legislative history. Thus it was incumbent upon the appellee to deal with these arguments if they were to be answered at all.

What is the substance of the appellee's arguments?

The first portion of his statement consists of quotes from Section 381(a), and the explanation of them, from the FDA's point of view, which was given during the lower court's proceedings. After introducing another immigration case (see previous discussion, p. 4-5, of this brief), the appellee at last begins to discuss, not an argument made by the opening brief, but rather two cases introduced by it. These cases are *Abbott* and *Toilet Goods Ass'n., Inc. vs. Gardner* (1967) 387 U.S. 158.

The government's brief attempts to limit the implications on APA application by its reading of the import of the two cases. It is true that *Abbott* decided that regulations could be reviewed in a pre-enforcement state. But the major significance of the decision, as borne out by the lengthy quotations of the *Abbott* case found in the appellant's open-

ing brief, is that the judicial review sections of the APA apply to FDA-promulgated regulations. Following from this decision the appellant concluded (p. 13) "The FDA lacks absolute discretion when promulgating regulations; logic dictates that if regulations are reviewable, that determinations also be reviewable." The appellant's arguments on this subject are among the many not spoken to.

Incidentally, the respondents in commenting upon the effect of *Abbott* and *Toilet Goods* state that those cases involved entire industries whereas the instant case does not. Such a contention is manifestly false. For, if determinations under Section 381(a) are held to be subject to judicial review under the APA, every importer of food and drug items in the United States would be affected. But, even if respondents' statement were true, is the right of one individual so insignificant that he would be denied what is justly his, i.e., protection of his right to a fair hearing and judicial review?

2. <u>The Food and Drug Administration does not possess absolute discretion over the admissibility of imports.</u>

In the recent coffee import-export action involving Section 381, *Carl Borchsenius Co., Inc vs. John W. Gardner, et al., supra,* the District Court said:

> "The Court agrees that generally speaking judicial relief is not appropriate to relieve a party from administrative action if the administrative agency has exercised discretionary authority granted to it under a statute. *Panama Canal Co. vs. Grace Line, Inc.*, 356 U.S. 390, 78 S.Ct. 752, 2 L.Ed. 2d 788 (1958);

Sugarman vs. Forbragd, 267 F. Supp. 817 (N.D. Cal., 1967); see also *Magnolia Petroleum Co. vs. Federal Power Commission*, 236 F. 2d 785 (C.A. 5, 1956); *Chernock vs. Gardner*, 360 F. 2d 257 (C. A. 3, 1966); *Ferry vs. Udall*, 336 F. 2d 706 (C. A. 9, 1964), cert. den. 381 U.S. 904. On the other hand it is well settled that judicial relief is appropraite to relieve aggrieved persons from administrative action beyond the statutory grants of authority. In *Stark vs. Wickard*, 321 U.S. 288, 64 S.Ct. 559, 571, 88 L.Ed. 733, the Supreme Court said:

'* * *When Congress passes an Act empowering administrative agencies to carry on governmental activities, the power of these agencies is circumscribed by the authority granted. This permits the Courts to participate in law enforcement entrusted to administrative bodies only to the extent necessary to protect justiciable individual rights against administrative action fairly beyond the granted powers. The responsibility of determining the limits of statutory grants of authority in such instances is a judicial function entrusted to the courts by Congress by the Statutes establishing courts and marking their jurisdiction. * * *'

To the same effect *Waite vs. Macy*, 246 U.S. 606, 38 S.Ct. 395, 62 L.Ed. 892 (1918); *Hammond vs. Hull*, 131 F.2d 23 (C.A. D.C., 1942); *Bowman vs. Retzlaff*, 65 F. Supp. 265 (D.C. Md. 1946)."

It is the appellant's view that the facts of *Sugarman vs. Forbragd* warrant its removal from its present position in the above quote to a place alongside of *Waite vs Macy* and *James J. Hill (Bowman vs. Retzlaff)*, where it would be used to illustrate that "judicial relief is appropriate to relieve aggrieved persons from administrative action beyond the statutory grants of authority."

How does one determine if administrative action has gone beyond statutory limits? This very question was asked of the

present appellee by the District Court in the following interesting exchange (II R. 72-74):

> "THE COURT: All right, gentlemen, why shouldn't I send this case back to the Food and Drug Administration?
>
> MR. ENSIGN: Well, because, Your Honor, the Court doesn't have the power to conduct a judicial review.
>
> THE COURT: Why not?
>
> MR. ENSIGN: Because this is a case where the agency action is committed to the agency discretion.
>
> THE COURT: It says, 'it it appears from the examination...' What does that mean?
>
> MR. ENSIGN: It means that if in the opinion of the Food and Drug Administration, from the examination or otherwise, the article is not fit for food...
>
> THE COURT: How does he exercise that discretion, don't bother me, that stuff burned on the ship, appears to me that's no good, that's the end of it, I don't want to hear any more. I have made my ruling. I have exercised my discretion. You mean to tell me the Food and Drug can go that far, even under import theory?
>
> MR. ENSIGN: Might act beyond the statutory authority, in which case no court would be deprived of the power to conduct a judicial review.
>
> THE COURT: How do I determine whether he acted beyond his statutory authority?
>
> MR. ENSIGN: Well, the complaining party has the right to --
>
> THE COURT: He has, he's coming here and he says, you've held all the cards up to your chest. You haven't shown me a single card. Now, that's not the exercise of discretion that's contemplated here, when it says

'appears,' has to appear not only to -- in a sense to -- while the statute makes discretionary -- administrative officer, and has to appear to him, but that appearance to him has to be a reasonable appearance, and somebody's got a right to examine to see whether it's a reasonable appearance.

MR. ENSIGN: So long as he acts within his statutory authority, our position is that the Court has no power for judicial review, and so long, of course, as the statute is constitutional as it is."

We regret that the line of questioning did not return, and require of the appellee his answer to the Court's inquiry, "How do I determine whether he acted beyond his statutory authority?" The appellant gives his answer as follows: An official who bypasses the use of reasonable standards, as envisaged by Congress, for judging products under his jurisdiction is acting in an arbitrary and capricious manner and thereby exceeding his statutory authority.

Why should the FDA be held to reasonable standards and where do such standards come from?

In answer to the first question one might simply say "fairness." But the appellant, in addition, relies upon the law as follows:

Regarding the basis on which the coffee beans of this case were detained, the government in its briefs limits itself to a reading of Section 381(a). In these briefs it fails to mention that the actual basis of detention is found in previous passages of the FDC Act. In its original "Notice of Detention and Hearing," however, the government does

acknowledge that Section 342, not Section 381, contains the basis of detention when it states:

"Adulterated within the meaning of Section 342(a)(3)"[3]

Thus the legality of an import detention made by the FDA rests on its proper implementation of Section 342 as well as 381. On this subject the opinions of Justice Jerome N. Frank are instructive.

In *U.S. vs. 449 cases... Tomato Paste*, (C.C.A. 2d 1954) 212 F. 2d 567 concerning the application of Section 342(a)(3) to an allegedly adulterated product from Portugal, the appendix to Justice Frank's dissenting opinion gave a history of Section 342(a)(3) and he warned against the application of undisclosed standards in judging adulteration, in his opinion, supra, page 579:

> "Unhampered discretion of the type conferred by 21 U.S.C. §342(a)(3) is at best, insiduous. Possessed of such power, an official may stop the sale of perfectly good food merely because he happens not to like it.
>
> Such a possibility should cause courts like ours, when they can, to insist that administrative officers exercise wide discretionary powers only in accordance with any statutory provision which requires that they commit themselves to *properly publicized standards*. In that way, to some extent at least, can there be reconciled unavoidable delegation of exten-

---

3. Other statutory provisions of the FD&C Act may be the basis of detention such as Section 502 (21 U.S.C. §352) requiring devices to be labeled with "adequate direction for use" in *Canadian Memorial Chiropractic College v. Shumate*, (W.D. N.Y., Civil 1966-189, July 26, 1967).

sive discretion to administrators with needed protection of the individual."
(Emphasis added.)

In *United States vs. 1,500 Cases*, 236 F. 2d 208, 211 (C.A. 7), 1956, the Seventh Circuit agreed with Justice Frank that the use of Section 342(a)(3) should be in accordance to reasonable standards:

> "The conclusion is inescapable that if we are to follow the majority of the decisions which have interpreted 21 U.S.C.A. Section 342(a)(3), without imposing some limitation, the Pure Food and Drug Administration would be at liberty to seize this or any other food it chose to seize. And there could be no effective judicial review except perhaps for fraud, collusion, or some such dishonest procedure. Such a position is not indefensible. Congress has obviously found it difficult, if not impossible, to express a definite statutory standard of purity that will receive uniform interpretation. And this court is acutely aware of the fact that it is not the proper body to more narrowly define broad standards in this area so that they can be applied in a particular case. Courts know neither what is necessary for the health of the consuming public nor what can reasonably be expected from the canning industry. Furthermore, this is not a determination that should be made individually for each case on the basis of expert testimony. The Food and Drug Administartion should set definite standards in each industry which, if reasonable, and in line with expressed Congressional intent, would have the force of law.
>
> Despite our limitations as a court and...Section 342(a)(3)..., we do not think that Congress intended to let the acts of the agency under this subsection go completely without limitation ...
>
> The spirit of...(sections of the FD&C Act)... demands that we give effect to what reasonable standards have been set by the Food and Drug Administration in the area involved in this case, and determine them as best we can where they have not yet been established..."

The appellant agrees with Justice Frank and the Seventh Circuit that "The FD&C Act should set definite standards in each industry which, if reasonable, and in line with expressed Congressional intent, would have the force of law." If the government were to establish standards for coffee, the validity and reasonableness of the standards could be reviewed under Section 701(3), (f) and (g) (21 *U.S.C.* 371(e), (f) and (g).) In the present situation the government sets no regulations which the court can examine and, through a claim of absolute discretion, seeks to avoid being bound by any standards at all. The appellant feels that this claim is contrary to the intent of Congress in writing Sections 401, 402 and 701 of the *FD&C Act*, as well as the cases cited above.

Regarding the second question above, as to the source of reasonable standards, the answer is that they may be developed either by government or by industry. Section 401 of the 1938 Act (21 *U.S.C.* 341) authorizes the government to promulgate regulations fixing reasonable standards of identity, quality, and fill of containers for most foods, including coffee, whenever "such action will promote honesty and fair dealing in the interest of consumers." Reasonable standards have been set regarding many foods, establishing guidelines which are an aid both to government and industry. However, in the case of coffee the government has promulgated no regulations fixing reasonable standards, and so both government and industry have looked to the standards established by the coffee industry.

A mistaken basis of the government's theory of absolute discretion is *Buttfield vs. Stranaham*, 192 U.S. 470 (1903) involving the *Tea Importation Act*, 29 Stat. 604 (1897) as amended, 21 *U.S.C.* §41 et seq. (1946) which had authorized the establishment of standards for the importation of teas. *Buttfield vs. Stranaham* involved an administrative refusal to admit into the United States a shipment of tea found by a board of general appraisers to be below certain *standards* authorized by the Tea Inspection Act. The court upheld the government on the basis that it had made a proper decision in accord with known standards. *The Court did not rule that Congress had vested the administrative agency with absolute discretion* to make determinations as to the admissibility of teas.

In *Waite vs. Macy*, 246 U.S. 606 (1918), the Supreme Court of the United States granted an injunction to a tea importer requiring the Tea Inspection Board to admit a shipment of tea which it had rejected. Since Section 6 of the *Tea Importation Act* required that regulations be in line with "the usages and customs of the tea trade," and the regulations which the government board had promulgated and acted upon did not meet this requirement, the court held that the government had exceeded its statutory authority. Both the *Waite vs. Macy* and the *Buttfield vs. Stranaham* decisions are based on a single premise; that the government's discretion over tea imports is limited to judging according to specific standards. Moreover, teas are excluded from the country only if the product

does not meet the minimum standards of the tea trade, *Macy vs. Brown*, (CCA-2, 1915) 224 Fed. 359, aff'd 246 U.S. 606 and *Macy vs. Loch*, (CCA-2, 1913) 205 Fed. 727.

D. SINCE TRIABLE ISSUES OF FACT EXISTED, THE GRANTING OF A SUMMARY JUDGMENT BY THE DISTRICT COURT WAS IMPROPER.

In *The James J. Hill*, 65 F. Supp. 265, 266-267, (D.C. Md 1946), complainant raised two issues: "(1) that there was no substantial evidence before the respondents (The FDA) that the wheat was unfit for food and that their action is therefore arbitrary and capricious; and (2) that the Federal Security administrator did not afford the plaintiff a fair hearing."

The District Court dismissed the second issue on a basis dealing with procedure.[4]

---

4. The plaintiff's procedural difficulty came about as follows. A portion of a shipload of wheat, water-damaged enroute, was detained and a hearing held at which it was conceded that the wheat in its then condition was unfit for import. The owner subsequently made application to recondition the damaged wheat. He received permission to do so, and also instructions to report the proposed method of reconditioning and the purpose for which the wheat would be used. "It appears that the owner...did not make formal written application but did informally and by correspondence with the Administrator request the release of the wheat, then in process of being dried out, for use as poultry food...(Then) the owner requested a hearing by the Administrator with an opportunity to submit testimony 'as to the present condition of the damaged wheat and particularly on the question of the fitness of said wheat for animal foods'... The Administrator replied...that a hearing under the Act had already been given and that the request for the use of the wheat as poultry feed was denied and declined to accept the invitation to participate in...controlled feeding tests."

This case history, incidentally, is a good illustration as to why this appellant believes that the uniform procedures of the APA should be utilized in import determinations.

Regarding the first issue, the Court heard detailed scientific testimony from both the government and the owner as to whether the wheat was unfit for food.

The appellee in the instant case objects to the term *de novo* when applied to the *Hill* trial on the grounds that the ultimate purpose of hearing the testimony was to determine not the state of the wheat but if the government administrator had acted in an "arbitrary and capricious" manner. It is the appellant's view that the term *de novo* is properly applied because the total facts of the case were reviewed by the court. But to quibble over Latin terminology is beside the point; the crux of the matter is that the *Hill* case is one in which the issues were almost identical with those of the present case and in which the court did examine the facts of the case from its inception. The *Hill* precedent, then, presents a compelling argument as to the propriety of the District Court's having examined the following issues here:

1. Whether this importer received a fair hearing;
2. Whether there is no substantial evidence that the said coffee beans are unfit for food.

In actuality, the District Court did not consider any evidence that the said coffee beans were unfit for food (II R. 74) as shown by its statement:

> "...I'm going to admit all of the exhibits. In so doing, I do it with the following observation, that the admission of some of these exhibits, particularly the Government's exhibits that have to do with analyses made

> in Washington, analyses made in San Francisco, is not being admitted for the truth of what is contained therein, but as the basis for the action of the administrative officer. So that I'm admitting it...in that sense and for that purpose."

Nor did it take under consideration evidence that the coffee was fit. Part of this evidence took the form of the testimony of two coffee experts who testified at the hearing conducted by the FDA in the proceeding. W. L. McClintock testified (Appellant's Exhibit "I-1" page 42, lines 16 to 26) that the beans, in terms of flavor and color, was coffee and had commercial value. (See Appendix).

J. K. Dominguez, another expert, also testified (Appellant's Exhibit "I-1" p. 47, lines 14 to 26) that the beans were a coffee and had commercial value. (See Appendix).

Unquestionably the testimony of these two experts present triable issues. "Is the coffee a food within the FD&C Act" is a question that should have been determined after a full and complete proceeding in the District Court and not as has been done in this instance in a summary proceeding.

E. THE INSTANT CASE IS NOT AN UNCONTESTED SUIT AGAINST THE U.S.

The instant case was not an uncontested suit against the sovereign as respondents attempt to contend. It was, as has been previously demonstrated, an appeal from an adverse decision made by the FDA in derogation of rights granted appellant under the APA, and, further, an appeal for review based upon the provisions of the FD&C Act and the APA.

CONCLUSION

This case basically concerns the most important matter of assuring that procedural safeguards are available when private citizens deal with their government. Regarding applying these procedural safeguards in the area of import determinations, *Willapoint Oysters Inc. vs. Ewing, et al.*, 174 F.2d 676, 686, cert. den. 338 U.S. 890 (1949) contains very pertinent commentary. The appellant concludes the presentation of his case with the following statement of the Ninth Circuit:

> "When it enacted the Administrative Procedure Act in 1946, with its review proceedings (5 U.S.C.A. §1009) Congress did not see fit to amend the provisions of the Food and Drug Act (21 U.S.C.A. §371) relating to the scope of review proceedings under the latter Act, and for this reason Circuit courts face the task of harmonizing the review provisions of both pieces of legislation. The review provision of both Acts are in *pari materia;* both relate to the same matter or subject, and it is our view that they dovetail and should be considered together and given effect..."

Dated: April 19, 1968, at San Francisco, California.

Respectfully submitted,

GEORGE McKRAY and
SHELDON I. BALMAN

GEORGE McKRAY

By _____
George McKray
Attorneys for Appellant

STATE OF CALIFORNIA]
] No. 22,102
City and County of San Francisco]

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE A. McKRAY

George A. McKray
Attorney for Appellant

AFFIDAVIT OF SERVICE BY MAIL

STATE OF CALIFORNIA]
] No. 22,102
City and County of San Francisco]

ROBERT L. JOHNSON, being duly sworn, says: That he is a citizen of the United States, over 18 years of age, not a party to the within action. This affiant's business address is 1255 Post Street, Suite 625, San Francisco, California. That affiant served copies of the attached APPELLANT'S REPLY BRIEF, on each of the following at their respective addresses by placing said copies in envelopes addressed as follows:

Cecil F. Poole
U.S. Attorney
Robert N. Ensign
Assistant U. S. Attorney
450 Golden Gate Avenue
San Francisco, Calif.
(3) copies

Arthur Dickerman, Esq.
FDA District Office
1521 W. Pico Blvd.
Los Angeles, Calif. 90015
(3) copies

which envelopes were then sealed and postage fully prepaid thereon, and thereafter were on April 19, 1968, deposited in the United States Mail at San Francisco. That there is delivery service by United States mail at the places so addressed, or regular communication by United States mail between the place of mailing and the places so addressed.

ROBERT L. JOHNSON

Robert L. Johnson

Subscribed and sworn to before me
this 19th day of April, 1968.

GRACE G. HACKETT

Grace G. Hackett, NOTARY PUBLIC
In and for the City and County of
San Francisco, State of California
My commission expires Feb. 9, 1971.

APPENDIX

W. L. McClintock testified as follows. (See Appellant's Exhibits "I-1" page 42, lines 16 to 26.):

"Q. And you prepared and examined this coffee according to the accepted method of cupping in the coffee industry?

A. Yes.

Q. According to a *set* condition?

A. Yes. The standard that is recognized throughout the United States.

Q. Well, in your opinion, in terms of flavor and color, is this coffee?

A. Yes, indeed, it's coffee.

Q. Does it have commercial value?

A. Yes, it certainly has."

J. K. Dominguez, another expert testified as follows. (See Appellant's Exhibits "I-1" page 47, lines 14 to 26.):

"Q. And you were given some of the reconditioned coffee?

A. Yes, I was.

Q. And did you prepare and examine this coffee according to the accepted methods of cupping in the coffee industry?

A. Yes, I did.

Q. Do you consider this a coffee?

A. Yes, I do.

Q. Does it have commercial value?

A. Yes, it has commercial value."

No. 22,104-A

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN BECKER,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the Northern District of California, Northern Division

APPELLANT'S OPENING BRIEF

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No. 22,104-A

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN BECKER,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the Northern District of California, Northern Division

APPELLANT'S OPENING BRIEF

JURISDICTION

Appellant was indicted on August 5, 1966, by the Federal Grand Jury, United States Court for the Northern District of California, Criminal No. 14748, for the violation of 18 USC 371, 26 USC 5205 (a) and 26 USC 5604 (a) (1) and was tried before the Honorable Thomas J. McBride and a jury, commencing February 28, 1967. (CT 2; RT 3.) Appellant was convicted on all three counts and sentence was pronounced on May 12, 1967. Appellant filed a timely notice of appeal on May 19, 1967.

The District Court assumed jurisdiction under the provision of Title 18 USC 3231. This Court has juris-

diction to review this judgment under Title 28, USC 1291.

STATEMENT OF THE CASE

The appellant, Mike A. Thomas, in his Opening Brief in Action No. 22,104-B has made a fair and rather complete statement of the case and therefore it would be merely repetitious to go through the same facts in this brief and accordingly this appellant adopts and incorporates by reference herein the statement of the case by appellant, Mike A. Thomas, and will allude to appropriate facts of the case in his argument as is necessary.

ISSUES

The appellant raises seven issues in this appeal which are as follows:

1. *Venue*—The appellant was entitled to be tried in the United States District Court for the Northern District of California, Northern Division, and it was error to require that he be tried in the Eastern District.

2. *Violation of Constitutional Guarantee*—The statements of the appellant admitted into evidence were admitted over the objection of the appellant and in violation of the constitutional guarantees enumerated in *Escobedo* and *Miranda*.

3. *Illegally Obtained Evidence*—The introduction into evidence of tape recordings of the appellant was prejudicial error.

4. *Entrapment*—The appellant was entrapped as a matter of law.

5. *Consent*—The Government, in fact, consented to the conduct of the appellant.

6. *Evidence of Other Crimes*—The introduction of evidence purporting to establish other crimes or misconduct was prejudicial error.

7. *Violation of Privilege Against Self-Incrimination*—The law under which appellant was charged requires self-incrimination and there was no effective waiver of the privilege against self-incrimination by the appellant.

ARGUMENT

I

VENUE

Appellant Was Entitled to Be Tried in the U.S. District Court for the Northern District of California, Northern Division, and It Was Error to Require That He Be Tried in the Eastern District

The indictment in this matter was filed in the United States District Court for the *Northern District of California, Northern Division.* (Clerk's Transcript (hereinafter referred to as C.T.) p. 1.) The appellant, pursuant to said indictment, was arraigned and pleaded not guilty to the charges of the indictment. The indictment was dated August 5, 1966. On September 18, 1966, pursuant to Public Law 89-372 80 Statute 75, the State of California was divided into four Judicial Districts to be known as the Northern, Eastern, Central and Southern District of Cali-

fornia. Included in the Eastern District is the County of Sacramento. Pursuant to the same Public Law, Court for the Northern District was to be held at Eureka, Oakland, San Francisco and San Jose but not Sacramento County. The appellant objected to the place of trial being set for the Court House of the Eastern Judicial District in Sacramento, California, contending the case should be tried in a court in the Northern District. Over his objection, the trial was set for Sacramento and the appellant thereafter filed a petition for leave to file petition for Writ of Mandamus and Prohibition. The petition was summarily denied. It is, nevertheless, the contention of the appellant that having been indicted in the *Northern District of California,* Northern Division, that he was entitled to be tried in a court in the *Northern District.*

> "Whenever any new district or division is established or *any county* or territory *is transferred from one district or division to another district* or division, prosecution for offenses committed within such district, division, county or territory prior to such transfer shall be commenced and *proceeded with the same as if such new district or division had not been* created, or *such county or territory had not been transferred, unless* the court, upon the application of the defendant, *shall order the case to be removed to the new district,* or division for trial." 18 USCA 3240. (Emphasis added.)
>
> ". . . The trial court was clearly right in refusing to order a transfer beyond its power and authority to grant, and its jurisdiction to proceed with the trial in *the district in which the crime was committed, the same as if the new district had*

not been created, is plain. . . ." *Hale v. United States,* 25 Fed. 2d 430 (8th Cir. 1928). (Emphasis added.)

"The question seems hardly open for further discussion since the opinion of the Supreme Court in *Lewis v. United States,* 279 US 63, 49 S. Ct. 57, 73 L. Ed. 615.

"We can see no difference in the controlling facts in that case and those in this. There, by Act of Congress, that part of the territory (Tulsa County) in which the crime was committed and other counties were taken from the district of which they were then a part and put into a new district, and after that defendants were indicted in the old district. The objection was held to be without merit. . . . That section means, according to its plain terms, that the prosecution of all crimes and offenses committed within the territorial limits of the old Southern District shall be commenced and proceeded with the same as if the place in which they were committed had not, after the commission thereof, been detached from the territorial limits of said district. That seems plain and was so held in the *Lewis* case, supra, . . ." *Mizell v. Vickrey,* 36 Fed. 2d 327, 329 (10th Cir. 1929).

It is the appellant's contention that both the cases and the Code Section clearly hold that the fact that Sacramento had been removed from the Northern District did not authorize the trial in the new Eastern District, to wit, Sacramento. The appellant was indicted in the Northern District and therefore should have been tried in the same district—the refusal of this right was error.

II

VIOLATION OF CONSTITUTIONAL GUARANTEES

The Statements of the Appellant Admitted Into Evidence Were Admitted Over the Objection of Appellant and in Violation of the Constitutional Guarantees Enumerated in Escobedo and Miranda

The Agent, Courtney, met appellant in September, 1962. (Reporter's Transcript (hereinafter referred to as R.T.) p. 664, lines 16-20.) In October, 1962, appellant was arrested and after a plea of guilty was sentenced to jail and placed on probation. The 1962 charge dealt with violations of similar type laws to those involved in the case at bar. When appellant was released on probation, the Agent, Courtney, continued his pursuit of the appellant until appellant was arrested again in August of 1966, in the present matter. Concededly, at no time after being placed on probation up until his arrest in August of 1966, was appellant ever advised of his constitutional rights to remain silent, and to have counsel as spelled out in *Miranda v. Arizona,* 384 US 436, 16 L. Ed. 2d 694, 86 S. Ct. 1602 and *Escobedo v. Illinois,* 378 US 478, 2 L. Ed. 2d 977, 84 S. Ct. 1758. (R.T. 370, lines 22-26; R.T. 371, lines 1-21; R.T. 895, lines 9-11.) The transcript contains volumes of statements made by appellant to the Government agents and testified to by the agents. The basic question in this regard is whether there was any obligation on the part of the Government or its agents to so advise appellant of his constitutional rights. The appellant contends that there was such an obligation and relies on two different principles in support thereof. First, appellant contends that he was, in fact,

in custody at all times during the period he was on probation and this type of custody is not made an exemption or exclusion by *Miranda* or *Escobedo* and therefore the right to be advised existed.

> "By custodial interrogation we mean questioning initiated by law enforcement officers after a person has been taken into custody or *otherwise deprived of his freedom of action in any significant way.*" *Miranda v. Arizona, supra,* page 706 (16 L. Ed. 2d). (Emphasis added.)

A person on probation is one that is "deprived of his freedom of action in any significant way".

> ". . . While on probation, the prisoner continues to be, in a sense, in custodia legis, . . ."
>
> *Peder v. Fleming,* 153 Fed. 2d 800 (D.C. 1946).

The rules of *Miranda* and *Escobedo* do not exclude this situation and therefore appellant was entitled to this advice and failure to give it constitutes error.

Secondly, the investigation was no longer a general inquiry into an unsolved crime but had begun to focus on a particular suspect, to wit, the appellant. *Escobedo* established that in this situation, the appellant was entitled to be advised of his rights which, of course, he was not. This also was error.

III

ILLEGALLY OBTAINED EVIDENCE

The Introduction Into Evidence of the Tape Recordings of the Appellant Was Prejudicial Error

There were numerous tape recordings of conversations between appellant and the agent that were introduced into evidence and played to the jury. (Ex. B, V-1, V-2.) The introduction into evidence and the playing thereof were objected to by appellant on the basis that no proper legal authority had been granted to the Government to engage in this type of conduct. (R.T. 679, 680.) It must be conceded that there was no legal authorization granted for the use of the recording devices on the appellant—there was no "Antecedent justification before a magistrate" as referred to in *Osborne v. United States,* 385 US 323, 17 L. Ed. 2d 394, 400, 87 S. Ct. 429.

It is the contention of the appellant (as it was at the trial also) that in a case such as the present one, under the principles of the *Osborne* case, it was incumbent upon the Government to acquire judicial authority before it set about to "bug" individuals. The Justices in the *Osborne* case clearly enunciated their fears of the indiscriminate use of the modern electronic devices and ultimately came to the conclusion in that case:

> "There could hardly be a clearer example of 'the procedure of antecedent justification before a magistrate that is central to the Fourth Amendment' *as 'a precondition of lawful electronic* surveillance.'". (Emphasis added.)

The death knell to this type of indiscriminate "bugging" was finally sounded in *Berger v. New York,* 18 L. Ed. 2d 1040, where the Court struck down a New York statute authorizing electronic eavesdropping. What had previously been a vocal minority on the issue of electronic eavesdropping or "bugging" and judicial regulation thereof, now became the majority and held that electronic eavesdropping or bugging is a form of search and seizure that must be exercised under the standards set by the Fourth Amendment. There is also a question whether indiscriminate use of such devices raises grave constitutional questions under the Fifth Amendment. The Court then analyzed the procedure followed in *Osborne v. United States,* 385 US 323, 17 L. Ed. 2d 394, 87 S. Ct. 429 and stated at page 1051 of 18 L. Ed. 2d:

> ". . . Through these strict precautions the danger of an unlawful search and seizure was minimized."

Clearly, in the present case, there was no precautions, there was only "indiscriminate" eavesdropping and bugging, the very things that the now majority of the Supreme Court has been criticizing, since *On Lee v. United States,* 343 US 747, 96 L. Ed. 1270, 72 S. Ct. 967.

Appellant, therefore respectfully argues that the "bugging" accomplished in the present case did not comply with the safeguards established judicially and constitutionally and to admit the same in evidence, over appellant's objection was error.

It has also been brought to appellant's attention, within the last month, that there was additional "electronic eavesdropping" that was not made known to Court and counsel wherein the appellant's conversations with his co-defendant were recorded. There can be no dispute that such is illegal and any fruit borne thereby must be similarly tainted. This, of course, cannot be determined without a full disclosure of the contents of the tapes.

IV

ENTRAPMENT

The Appellant Was Entrapped As a Matter of Law

This case probably reaches the heights to which a Government agent will go to acquire a conviction. Perseverance, in and of itself can be a virtue, but where, as here, the perseverance was utilized to get the appellant to *commit* a crime, then the halo disappears and it clearly becomes a vice. That Agent Courtney did everything within his power to have the appellant commit a crime is without dispute. Without lingering too long on the specific facts, it suffices to say that he:

1. Posed as a big time gangster—a member of the syndicate (R.T. 831, lines 16-24); "Mr. Big" of a big syndicate (R.T. 852, lines 12-17);

2. Represented that his organization dealt severely with those who would disobey its orders, desires or mandates (R.T. 897, lines 24-26; R.T. 898, lines 1-2);

3. Represented that he was in trouble with his superior because appellant and co-defendants

were not producing or delivering (R.T. 893, lines 8-18; R.T. 905, lines 14-22);

4. Offered assistance by way of money, equipment for a still, sugar, a still site, or personnel (a still jockey) (R.T. 906, lines 3-14; R.T. 908, lines 10-17; R.T. 911, lines 3-7; R.T. 933, lines 10-12; R.T. 935, lines 21-26; R.T. 936, lines 1-8).

Despite all of this, and with all of this, it took the Agent 2½ years to get the appellant to allegedly commit a crime and then only with the Agent and because of the Agent.

Appellant respectfully contends that this type of conduct on the part of a law enforcement officer has not and will not be tolerated. There is no way to even effectively gauge the quantum of fear a man may have when one morning he awakens and believes he is married to a criminal syndicate. The Government should not be allowed to engage in this sort of a masquerade.

". . . And while it may be true that the mere aiding of one in the commission of a criminal act by a government officer or agent does not preclude the conviction of the party committing the crime, yet where the officers of the law have *incited* the party to commit the crime charged and *lured* him on to its consummation, the law will not authorize a verdict of guilty." *Sam Yick v. United States,* 240 Fed. 60. (Emphasis added.)

"So one desiring to test a supposed liquor seller might represent himself to be such a person as can be trusted in such a transaction and do and say such things as would not be unusual in such dealings but he could not pretend sickness or *put*

> *extraordinary pressure upon his victim to get him to break the law* and of course *could not organize a liquor plot and then prosecute for it." United States v. Wray,* 8 Fed. 2d 429. (Emphasis added.)

Any quarrel with the statement that Agent Courtney incited, lured, put extraordinary pressure upon his victim and organized a liquor plot, would be to disregard completely and arbitrarily all of the evidence from the prosecution, as well as the defense, and *all* inferences therefrom.

If this were not enough to nullify the convictions, there still is to be considered the fact that in this 2½ year caper of the Agent, he failed to uncover or disclose any "bootlegging" by the appellant as respects other people—neither past nor present—thus the only crimes were with the Agent and because of his prodding.

> "The case differs from those where a just suspicion of offense already attaches to the defendant so that the agent's activities but expose and facilitate the proof of independently existing criminal activity rather than as the court put it (*Scott v. United States,* 43 L. Ed. 471) 'Placing temptation before a man and endeavoring to make him commit a crime.' The great difference is that the agent's activities must serve to throw light on independently existing criminality and must not themselves be the constitutive elements of all of the offense that is made to appear. . . ." *United States v. Campbell,* 235 Fed. Sup. 190.

If this Honorable Court accepts the foregoing as a correct principle of law, need appellant say more?

V

CONSENT

The Government In Fact Consented to the Conduct of the Appellant

It is without dispute that the only alleged misconduct on the part of the appellant is that of allegedly possessing an unregistered still and selling unstamped distilled spirits and also entering into a conspiracy relating to the same. It is also without dispute that the still was constructed at the Government's urging (through Agent Courtney) and was used solely for the purpose of supplying distilled spirits to the Government and the Government was the sole purchaser thereof. (R.T. 885, lines 24-26; R.T. 886, lines 1-7; R.T. 886, line 26; R.T. 887, lines 1-10.) Under the principle enunciated in the case of *Henderson v. United States,* 261 Fed. 2d 909, the appellant was acting as an agent for the Government. The Agent Courtney referred to them as partners and as indicated previously the only sales made were those to the Government and the still was created and operated at the Government's request for the Government. Again, this conduct was not used to discover other criminal activity, but rather to create a crime that could be prosecuted. The Government, through its agents, was clearly a participant and therefore there can be no crime.

VI

EVIDENCE OF OTHER CRIMES

The Introduction of Evidence Purporting to Establish Other Crimes or Misconduct Was Prejudicial Error

Over the objection of appellant, evidence was admitted connecting appellant with $40,000.00 of allegedly stolen bonds. The Court recognized this evidence as being prejudicial to the appellant. (R.T. 2136-2146.)

Again, over the objection of appellant, evidence was admitted connecting appellant with stolen cigarettes and illegal gold. (R.T. 2168-2182.)

Significantly, all that was introduced were statements and correspondence relating to these items with no proof that any of these things in fact existed or that appellant was connected with them. (R.T. 2216, lines 10-11; R.T. 2222, lines 18-26; R.T. 2223, lines 1-2; R.T. 2240, lines 19-26; R.T. 2241, lines 1-10.) The prosecutor alluded to all this allegedly nefarious conduct in his argument. (R.T. 2629, 2630, 2631; R.T. 2648, 2649.)

The prosecution recognizing the questioned relevancy and admissibility of the evidence justified the same on the basis that when the appellant raised the issue of entrapment, the prosecution was free to go into all these collateral matters. (C.T. p. 41.) Also, the prosecutor in distinguishing *DeVore v. United States,* 368 Fed. 2d 396 (9th Cir. 1966) stated that *DeVore* did not involve an entrapment defense, thereby contending that the rule would be otherwise where entrapment is involved.

DeVore, of course, stated the general principle:

> ". . . It is also clear, however, that evidence which discloses the commission of another offense should be excluded, even though relevant, if the value of the evidence is limited and the danger of prejudice from its use is great . . ."

However, this Court clearly answered the prosecution in this regard when it recently stated:

> "Evidence of prior acts of misconduct is not admissible unless in some way relevant to the crime charged and where entrapment is in issue evidence of prior crime is not relevant unless it tends to prove that defendant was engaged in illegal operation in some way similar to those charged in the indictment. Proof that a man is a burglar or drunk does not tend to show that he has dealt in narcotics and was prepared to deal in narcotics at the time of the asserted entrapment . . ." *DeJong v. United States,* 381 Fed. 2d 725, 726 (9th Cir. 1967).

Applied to the present case:

1. Proof that a man is a burglar (stolen bonds) does not tend to show that he has dealt in illegal stills and contraband distilled spirits and was prepared to deal in them at the time of the entrapment.

2. Proof that a mean deals in "gold dust" does not tend to show that he has dealt in illegal stills and contraband distilled spirits and was prepared to deal in them at the time of the entrapment.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Charles O. Morgan, Jr.,
Attorney for Appellant.

No. 22,104-B

IN THE

United States Court of Appeals

For the Ninth Circuit

MIKE A. THOMAS,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the Northern District of California, Northern Division

APPELLANT'S OPENING BRIEF

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APPELLANT'S OPENING BRIEF

JURISDICTION

Appellant was indicted on August 5, 1966, by the Federal Grand Jury of the United States District Court for the Northern District of California, Cr. No. 14748, for the violation of 18 U.S.C. 371; 26 U.S.C. 5601 (a) (1) and 26 U.S.C. 5604 (a) (1) and was tried before the Honorable Thomas J. MacBride and a jury commencing February 28, 1967 (C.T. 2; R.T. 3).

Appellant was convicted on all three counts (R.T. 2720) and sentence was pronounced on May 12, 1967 (R.T. 2792). Appellant filed a timely notice of Appeal on May 19, 1967 (C.T. 63).

The District Court had jurisdiction under the provision of Title 18 U.S.C. 3231. This Court has jurisdiction to review this judgment under Title 28 U.S.C. 1291.

STATEMENT OF THE CASE

Appellant was indicted on August 5, 1966, for violation of 18 U.S.C. 371, i.e. conspiracy to violate 26 U.S.C. 5601 and 26 U.S.C. 5604, which are the United States Revenue laws pertaining to possession of an unregistered still and the possession, transportation, sale or transfer of distilled spirits without the required stamp.

Appellant was further indicted for violation of 26 U.S.C. 5601 (a) (1) i.e. possession of an unregistered still required to be registered under 26 U.S.C. 5179 (a) and violation of 26 U.S.C. 5205 (a) (2) (C.T. 2, 3, 4).

Trial commenced before the Honorable Thomas J. MacBride sitting with a jury on February 28, 1967 (R.T. 3), and thereafter appellant was convicted on three counts on March 31, 1967 (R.T. 2720).

The indictment in this case covers the period of March 3, 1965, to June 4, 1966 (C.T. 2, 3, 4).

However, the testimony in the case relates back to September, 1962, at which time Thomas was first introduced to Jack Courtney by a Gerald Brown (R.T. 1835-1836) and at which time Jack Courtney was an

undercover agent for the Treasury Department, and posing as a gangster or member of the syndicate (R.T. 831; R.T. 936; R.T. 852-853).

Courtney agreed to buy alcohol from Thomas and Becker (R.T. 861) and Thomas and Becker proceeded to build a still in Sacramento to supply Courtney with alcohol. The still was raided in October, 1962, and the appellant was arrested and after a plea of guilty was sentenced to jail and placed on probation (R.T. 858; R.T. 2283 to 2288; R.T. 845-846; R.T. 1245-1246; R.T. 937; R.T. 964; R.T. 870-871).

While the 1962 case was pending and while Becker was out on bail, Courtney contacted Becker by telephone in order to determine whether Becker and Thomas had discovered Courtney's true identity (R.T. 842; 883; 948; 949; 951; R.T. 673; 674; 675; R.T. 861, 862).

During Courtney's 1962 association with Becker and Thomas, in order to play the part of a gangster, Courtney showed Becker and Thomas strip stamps; displayed labels in the back of his car; and told Becker and Thomas he had a bottling plant as part of the syndicate operation (R.T. 669; 671; 831; 850; 851; 852; 853).

It appears that in 1962, the only spirits ever furnished to Courtney was eight gallons (R.T. 941-942).

Courtney testified that in the year of 1963, he had no contact whatsoever with Thomas (R.T. 946, 947, 948, 949) but that in December, 1963, he did call Becker on the phone in response to a letter written by

Becker; that he had previously called Becker in December 1962, while Becker was out on bail for the first offense to determine if Becker knew Courtney was a Federal Agent (R.T. 946, 947, 948, 949, 950, 951, 952, 953; R.T. 842, 846, 847; R.T. 671, 672, 673).

Since the 1962 arrest of Thomas, Courtney had no contact with him until 1964. It appears Becker wrote a letter to Courtney in December, 1963, and Courtney thereupon phoned Becker in reply. On January 28, 1964, Courtney met Becker at Thompson Motors, where a meeting was arranged at the Hyatt House in San Jose. On February 8, 1964, Courtney saw Thomas for the first time since 1962 (R.T. 674, 675, 676, 693, 694; R.T. 2114).

Between February 8, 1964, and June 4, 1966, the testimony of Courtney on direct examination shows the following contacts between himself and the respective defendants:

December 16, 1963	Letter	Becker to Courtney	R.T. 67
December 24, 1963	Phone call	Courtney to Becker	R.T. 67
January 28, 1964	Phone call	Courtney to Becker	R.T. 69
February 8, 1964	Hyatt House	Courtney, Becker, Thomas	R.T. 69
March ....., 1964	Phone call	Courtney to Becker	R.T. 69
May 27, 1964	Hilton	Courtney, Becker, Thomas	R.T. 69
September 10, 1964	Letter	Becker to Courtney	R.T. 69
October 6, 1964	Letter	Becker to Courtney	R.T. 70
October 6, 1964	Phone call	Courtney to Becker	R.T. 70
October 19, 1964	Phone call	Courtney to Becker	R.T. 70
October 22, 1964	Phone call	Courtney to Becker	R.T. 70
October 22, 1964	Hilltop	Courtney and Becker	R.T. 70
October 22, 1964	Mac Hotel	Courtney, Becker, Thomas	R.T. 70

cember 7, 1964	Letter	Becker to Courtney	R.T. 708
cember 15, 1964	Phone call	Courtney to Becker	R.T. 713
nuary 6, 1965	Phone call	Courtney to Becker	R.T. 714
nuary 11, 1965	Phone call	Courtney to Becker	R.T. 715
nuary 27, 1965	Letter	Becker to Courtney	R.T. 716-720
bruary 23, 1965	Phone call	Courtney to Becker	R.T. 720
rch 3, 1965	Santa Rosa	Courtney, Becker, Thomas	R.T. 721
rch 18, 1965	Phone call	Courtney to Becker	R.T. 724
rch 24, 1965	Phone call	Courtney to Becker	R.T. 725
rch 30, 1965	Sparks	Courtney, Becker, Thomas	R.T. 725
ril 8, 1965	Jack Tar	Courtney, Becker, Thomas, Jones	R.T. 729
ril 19, 1965	Phone call	Courtney to Becker	R.T. 731
ril 19, 1965	Phone call	Thomas to Courtney	R.T. 731-732
y 20, 1965	Letter	Becker to Courtney	R.T. 734
ne 13, 1965	Phone call	Courtney to Becker	R.T. 752
y 28, 1965	El Rancho	Courtney, Becker, Thomas	R.T. 753-754
tober 12, 1965	Letter	Becker to Courtney	R.T. 756
ober 14, 1965	Phone call	Courtney to Becker	R.T. 759
nuary 18, 1966	Phone call	Courtney to Becker	R.T. 763
bruary 15, 1966	Phone call	Courtney to Becker	R.T. 763
rch 8, 1966	Del Webb	Courtney, Becker, Greene	R.T. 764, 765, 766
ril 1, 1966	Letter	Courtney to Becker	R.T. 792, 793, 796
ril 11, 1966	Letter	Becker to Courtney	R.T. 797
ril 18, 1966	Phone call	Courtney to Becker	R.T. 798
y 28, 1966	Telegram	Becker to Courtney	R.T. 799-801
ne 1, 1966	Phone call	Courtney to Becker	R.T. 801
ne 2, 1966	Phone call	Courtney to Becker	R.T. 802
ne 2, 1966	Phone call	Courtney to Becker	R.T. 803
ne 4, 1966	Meeting at Thompson Motors	Courtney and Becker	R.T. 804

In addition to the above contacts related by Courtney on direct examination, further contacts between the government agents and Becker and Thomas are shown in Exhibit 1 (R.T. 288), Exhibit 2 (R.T. 303), Exhibit 3 (R.T. 470), Exhibit 4 (R.T. 470), Exhibit 7 (R.T. 909), Exhibit 8 (R.T. 922), Exhibit 9 (R.T. 923) and also (R.T. 832-839).

The first meeting since 1962, between Courtney and Thomas occurred at the Hyatt House in San Jose on February 8, 1964 (R.T. 966; R.T. 969), at which time Courtney was still posing as a big time gangster (R.T. 852-853; R.T. 883). At this meeting the defendants stated they had no still and Courtney offered to buy all they would sell him and set up an informal partnership (R.T. 884 to 887).

The second meeting between Courtney and Thomas occurred on May 27, 1964, at the Hilton Inn in San Bruno (R.T. 697) at which time Courtney complained that "The boss is on my back. I have to have something to tell him" (R.T. 893-894). Courtney further alluded to the "bottling plant" owned by the syndicate (R.T. 897).

The third time Courtney and Thomas met was on October 22, 1964, at the Mac Hotel in Richmond (R.T. 706) at which time Thomas delivered 10 gallons of spirits to Courtney and at which time Courtney showed great disappointment in the small amount (R.T. 899, 900).

It appears from the testimony of Curtice, called by the government that he had made the ten gallons in late 1964 (R.T. 57; R.T. 67) at Ceres, California,

and 35 gallons in November or December 1964, in Cloverdale (R.T. 58) and produced 60 gallons in Ceres, California, in May and June of 1966. That he produced no spirits in the year 1965 (R.T. 67, 68; R.T. 89, 90; R.T. 92).

Curtice further testified that during this period Thomas displayed concern over the "syndicate" and possible harm (R.T. 103-104).

The third meeting between Courtney and Thomas occurred on March 3, 1965, in Santa Rosa, California at the Los Robles Inn where Thomas delivered 35 gallons of spirits to Courtney (R.T. 721-722). At this meeting, a still site in Nevada was discussed (R.T. 724) and a meeting arranged in Sparks, Nevada (R.T. 724-725).

The fourth meeting between Thomas and Courtney occurred March 30, 1965, at Sparks, Nevada, at the Nugget Motel (R.T. 726-727) at which time Courtney agreed to furnish Thomas and Becker with a still site (R.T. 727-728).

The fifth meeting between Courtney and Thomas took place on April 8, 1965, at the Jack Tar Hotel in San Francisco. At this meeting Becker and Thomas introduced Billy Jones to Courtney stating he was a still operator (R.T. 729-730).

In connection with Billy Jones who went to the meeting of April 8, 1965, at the Jack Tar and claimed to be a still operator, Jones testified that Thomas asked him for a favor, that is, to pass himself off as a "still monkey" in order to placate the "syndicate" (R.T. 1657-1664).

A phone contact between Courtney and Thomas occurred on April 19, 1965, where Thomas phoned Courtney in Reno at Courtney's request and Thomas stated he did not care to set up the still at the Nevada site (R.T. 731-732).

The final meeting between Courtney and Thomas occurred on July 28, 1965, at the El Rancho in Sacramento (R.T. 753-754).

The testimony of the Government's witnesses is undisputed that in the years of 1964, 1965 and 1966, a total of 105 gallons of spirits was manufactured and all 105 gallons were sold to the Government agents and none sold to any other persons. R.T. 1006-1008 (Courtney), R.T. 57-59 (Curtice), R.T. 180 (Caughron), R.T. 552-553 (Bertolani).

The testimony of the Government witness regarding the undercover operation in the investigation of Thomas and Becker shows:

1. That Courtney posed as a gangster, a member of the syndicate (R.T. 179, R.T. 831; R.T. 853; 912; 914; 925; 934).

2. That Courtney offered a still site to the defendants in Nevada (R.T. 907; 910; 911).

3. Courtney offered to furnish a still monkey (R.T. 906).

4. Courtney arranges to furnish 2000 pounds of sugar to Thomas (R.T. 919; R.T. 517-518; R.T. 115; R.T. 249-254; R.T. 908).

5. Courtney offers to arrange to bribe Becker's probation officer (R.T. 884).

6. Courtney offered to try to get plastic containers for the defendants (R.T. 933).

7. Courtney knew that defendants were not in illegal operations in December, 1963 (R.T. 960-961), and knew they were on probation (R.T. 964).

8. Courtney offered to furnish a still to the defendants (R.T. 1039, 1040, 1043).

During the course of cross-examination of agent Caughron, by the attorney for Thomas, Caughron was asked if he had found anything to indicate that Thomas was a member of a gang. Caughron replied that he thought of Greene, Thomas and Becker as being a gang. In pursuing this answer for clarification Caughron stated Greene was in possession of $50,000.00 worth of stolen U. S. Bonds (R.T. 183-185).

Further testimony showed that Caughron had absolutely no evidence that Thomas had ever associated with Greene (R.T. 187-188; R.T. 190) nor was Thomas present with Greene at the meeting at the Del Webb Towne House on March 8, 1966 (R.T. 764-765) nor was there evidence that Thomas had any knowledge of the Bonds (R.T. 785-786).

At this point, attorney for Greene moved for a mistrial which was joined in by Thomas and Becker; the Court denied all motions (R.T. 192-234).

A motion to strike the testimony relating to stolen bonds was then made by Thomas (R.T. 235-236).

The motion to strike was granted as to Greene and Becker (R.T. 239) but overruled as to Thomas (R.T. 239-240) although there was no testimony to connect Thomas with the Bonds (R.T. 241; R.T. 785-786).

During the examination of Courtney, a letter from Becker to Courtney was produced (Government's No. I) which referred again to the Government Bonds and that part referring to the Bonds was deleted by the Court (R.T. 756, 757, 758).

Courtney testified that on March 8, 1966, he met Becker and Greene at the Del Webb Towne House in San Francisco (R.T. 764, 765).

On Voir Dire examination out of the presence of the jury, the Government Bonds were again brought up by Courtney (R.T. 766-770). Over objection of counsel (R.T. 770-789) the Court allowed the testimony of the Bonds before the jury (R.T. 791).

Government Exhibit F was produced, being a letter from Becker to Courtney which letter referred to "butts" meaning illicit cigarettes which reference was deleted by the Court (R.T. 709-712).

Government Exhibit G was produced being a letter from Becker to Courtney and referring again to "butts" meaning illicit cigarettes which reference was deleted (R.T. 716-719).

Government Exhibit J was produced being another letter from Becker to Courtney but referring to "yellow dust" meaning gold to be smuggled which reference was deleted (R.T. 793-797).

On rebuttal, the assistant United States Attorney produced Government Exhibit F previously admitted with references to the Bonds deleted and now sought to have the deletions removed (R.T. 2136).

After arguments of counsel (R.T. 2137-2141) the Court ruled that all deletions from Government Exhibits F, G, I and J would be removed and the entire letters read to the jury (R.T. 2142-2146).

As a result of this ruling by the Court, the assistant United States Attorney was allowed to read into the record before the jury the entire letters without the deletions to wit: Government No. I (R.T. 2147-2149); No. F (R.T. 2166-2167); No. G (R.T. 2169-2170) and No. J (R.T. 2174).

In addition thereto, there was admitted into evidence Government Exhibit No. X which was a letter from Becker to Courtney and which referred to the allegedly stolen Bonds (R.T. 2159-2160).

The exhibits having been admitted over objection of counsel (R.T. 2136-2146), the assistant United States Attorney argued the other allegedly illegal activities i.e. stolen Bonds, illicit cigarettes, illegal gold to the jury (R.T. 2629-2632).

Thereafter, the Court in its instruction wholly failed to instruct on the matter of other crimes and misconduct so as to limit the application of such evidence regarding "stolen bonds" and "illegal cigarettes" as to Thomas and also failed to limit the application of other crimes and misconduct regarding "illegal gold" in relationship to the crimes charged in the indictment.

At R.T. 2983 the Court refers to the "existing intent or readiness or the willingness to break the law" without limiting the instruction to the charge in the indictment.

At R.T. 2685 the Court instructed:

> "In determining whether a defendant is willing to commit a crime charged against him in the indictment, you may consider all of the evidence in this case including prior convictions of crimes of a similar nature, prior misconduct of a defendant of similar nature, his conduct in dealing with the Government agents, including his relationship with those agents *in any and all matters and you may consider any other evidence which would indicate his state of mind and bear on the question of his existing intent, readiness or willingness to commit a crime.*"

Under these instructions defendant Thomas was, in effect, associated with the stolen Bonds and illegal cigarettes without any evidence to support such an association (R.T. 188, 190; R.T. 785, 786; R.T. 2215) and there is no evidence that there ever existed any stolen cigarettes (R.T. 2234) and that the "stolen bonds" were in fact, non-negotiable (R.T. 2241).

Further, the admission into evidence of illegal gold is not in fact supported by any evidence that it is illegal or that any crime or misconduct was involved (R.T. 2216-2218; R.T. 2220-2222).

I

THE FACTS ESTABLISH ENTRAPMENT AS A MATTER OF LAW AND IT WAS ERROR TO DENY THOMAS' MOTION FOR JUDGMENT OF ACQUITTAL

Every overt act alleged in the indictment is the result of the creative activities of the Government agents.

The evidence shows that the first contact made in relation to the present indictment was Becker who wrote a letter to Courtney on December 16, 1963 (R.T. 674), which letter no way implicates Thomas nor can it be said that any conspiracy existed at this point. The next contact was a phone call from Courtney to Becker on December 24, 1963, which was recorded by Courtney (R.T. 676). The phone call does not in any way establish a conspiracy (R.T. 693).

On January 28, 1964, Courtney called Becker to arrange a meeting at the Hyatt House in San Jose on February 8, 1964 (R.T. 694).

Due to the complete lack of any evidence of a conspiracy at this point, no letter or statement by Becker could be imputed to Thomas.

The first evidence implicating Thomas is a meeting at the Hyatt House on February 8, 1964, attended by Becker, Thomas and Courtney. This is the first evidence of any conspiracy or agreement of any kind and the co-conspirator was Courtney, who was an accomplice (R.T. 695), a feigned gangster who aided, abetted, induced and persuaded Thomas and Becker to deliver alcohol.

In spite of the pressures applied by Courtney, it was not until October 22, 1964, that 10 gallons of alcohol was delivered (R.T. 706).

Again, it was not until March 3, 1965, that 35 gallons were delivered in Santa Rosa (R.T. 721).

And finally, it was not until June 4, 1966, that 60 gallons were delivered to the agents (R.T. 804).

It stands undenied that the total alcohol made was 105 gallons and that all 105 gallons were sold to the Government agents.

On the 24th of April, 1966, the U. S. agents delivered 2000 pounds of sugar to Thomas so that the 60 gallons could be made (R.T. 58, 59; R.T. 93; R.T. 108, 109; R.T. 114 to 124).

From the first meeting between Thomas and Courtney on February 8, 1964, at the Hyatt House, it was not until the latter part of 1964, that Thomas made a small still (R.T. 56) and delivered 10 gallons (R.T. 706) after constant pressure by Courtney (R.T. 676, 694, 696, 697, 703, 705) on Becker, then on Becker and Thomas.

The facts are undisputed that it took Thomas from February 8, 1964, until June 4, 1966, a matter of 2 years, 3 months, to furnish 105 gallons of alcohol under pressure from a "syndicate" gangster.

There is absolutely no evidence that Thomas was engaged in any criminal activity between December 16, 1963, and late Fall 1964, when he finally made a still and produced 10 gallons of alcohol delivered to

Courtney on October 22, 1964, at the Mac Hotel (R.T. 706; R.T. 947).

In *Hamilton v. U. S.*, 221 F. 2d 611 at 614 (1955) 5th C.C.A. the Court stated:

> "When it is suspected that a crime is being committed, for instance, in the sale of narcotics, and the question is as to who is the guilty party traps may be laid by affording the suspect an opportunity to sell the same in order to catch the guilty person. A suspected criminal may be offered an opportunity to transgress in such manner as is usual therein, but extraordinary temptations or inducements may not be employed by officers of the government."

The Court held in *United States v. Wray* (1925 D.C.) 8 F. 2d 429, as follows:

> "Much confusion of thought has been occasioned by the use of the word 'entrapment' in this connection. Whenever an officer of the law, by any plan or contrivance, or opportunity presented, causes a person to commit a crime in which he is detected, the officer entraps the criminal. It may also be said that the particular offense would not have been committed except for the act of the officer. Nevertheless, it is well settled, when it is suspected that a crime is being committed, and the question is as to who the guilty persons are, that traps may be laid and baited as by decoy letters, by opportunity to sell whiskey or morphine, in order to catch the guilty person. On the other hand, officers of the United States may not induce persons who would not otherwise have committed crime, to violate the

laws, and then prosecute for it. A sound public policy and a decent fairness forbid it. It is not, therefore, properly speaking, the entrapment of a criminal that the law frowns down, but the seduction by its officers to commit crime. A suspected person may be tested by being offered opportunity to transgress in such manner as is usual therein, but may not be put under extraordinary temptation or inducement. Thus, a morphine peddler usually deals with addicts. An officer, in testing a supposed peddler, may properly pretend to be an addict, with their common discomforts and craving for the drug, thus giving color to the ruse, and he may offer a liberal price for the drug, and manifest considerable persistence, for these things are common in such dealings. But he could not pretend to be in excruciating pain, or to have a wife or friend in extremity of suffering, to appeal thus to humanity, or offer any fabulous price for the drug. So, one desiring to test a supposed liquor seller might represent himself to be such a person as could be trusted in such a transaction, and do and say such things as would not be unusual in such dealings, but he could not pretend sickness or put extraordinary pressure upon his victim to get him to break the law, and, of course, could not organize a liquor plot and then prosecute for it. The question, I repeat, is not one of laying a trap, or of trickiness or deceit, but one of seduction or improper inducement to commit crime. The former is permissible and often necessary to enforce the law. The latter is not."

In *Whiting v. U. S.*, 321 F. 2d 72 (1st C.C.A. 1963) the Court stated:

"We suggest, what we take to be in accord with Accardi v. United States, 5 Cir., 1958, 257 F. 2d 168, Cert. den. 358 U. S. 883, 79 S. Ct. 124, 3 L. Ed. 2d 112, that once government inducement has been shown, there are two issues. The government should establish that it engaged in no conduct that was shocking or offensive per se, and that the defendant was not, in fact, corrupted by the inducement."

In *Sherman v. U. S.,* 1958, 356 U.S. 369, 78 S. Ct. 819, 2 L. Ed. 2d 848, the Court stated:

"However, a different question is presented when the criminal design originates with the officials of the government, and they implant in the mind of an innocent person the disposition to commit the alleged offense and induce its commission in order that they may prosecute", citing:

Sorrells v. U. S., 287 U. S. 435, 53 S. Ct. 210.

In *Lopez v. U. S.,* 373 U.S. 427, 83 S. Ct. 1381, 10 L. Ed. 2d 462, the Court stated:

"The conduct with which the defense of entrapment is concerned is the *manufacturing* of crime by law enforcement officials and their agents. Such conduct, of course, is far different from the permissible and prevention of crime. Thus before the issue of entrapment can fairly be said to have been presented in a criminal prosecution, there must have been at least some showing of the kind of conduct by government agents which may well have induced the accused to commit the crime charged."

In *Hansford v. U. S.,* 303 F. 2d 219 (1962, D.C. C.A.):

> "But readiness and disposition is not established by evidence that the person is not 'innocent' in that he has a criminal record. Innocent in the context of entrapment means that the defendant would not have perpetrated the crime for which he is presently charged but for the enticement of the police official."

In *Banks v. U. S.*, 249 F. 2d 672 (1957, Ninth C.C.A.):

> "As the Supreme Court has stated of the defense against such use of the Court's process by entrapment to procure a conviction:
>
> "The defense is available, *not in the view that the accused though guilty may go free,* but that the government *cannot be permitted to contend* that he is guilty of a crime where the government officials are the instigators of his conduct."

It stands undenied by the testimony of the Government's witnesses that Courtney posed as a gangster and member of the syndicate; that he offered to furnish a still site; that he offered to furnish a still monkey; that he offered to furnish containers; that he furnished 2000 pounds of sugar; that he complained he was being "pushed" from his big boss; that he could fix a judge in Mexico; that he could arrange an abortion; that he could bribe Becker's probation officer.

This general course of conduct goes far beyond being a willing buyer or merely creating an opportunity for a defendant to break the law, and Thomas's Motion for Judgment of Acquittal should have been granted (R.T. 1104-1171).

II

IT WAS PREJUDICIAL ERROR TO ALLOW TESTIMONY OF OTHER MISCONDUCT AGAINST THOMAS

When Thomas's attorney was attempting to explore the alleged conspiracy between Thomas and Greene, Agent Caughron stated that Greene had $50,000.00 in stolen Bonds (R.T. 183-185).

Further testimony showed that Thomas was in no way connected with or had knowledge of these "stolen" Bonds (R.T. 187, 188, 190; R.T. 785, 786; R.T. 764, 765).

The Court overruled a motion to strike by Thomas (R.T. 239, 240) and allowed the testimony to stand.

The Court again allowed testimony of the Bonds before the jury by allowing a reading of Government Exhibit I (R.T. 2147-2149).

The Court further allowed a reading of Government Exhibit F which referred to stolen cigarettes; Government Exhibit G referring to stolen cigarettes; Government Exhibit J referring to illegal gold (R.T. 2166-2174); and there was further admitted Government Exhibit X again referring to the Bonds (R.T. 2159-2160).

In *Devore v. U.S.*, 368 F. 2d 396 (9th C.C.A.) the Court stated:

> "Evidence which discloses the commission of another offense should be excluded, *even though relevant,* if the value of the evidence is limited and the danger of prejudice from its use is great."

See also:

Powell v. U. S., 347 F. 2d 156 (9th C.C.A.).

In *De Jong v. U. S.,* 381 F. 2d 725 (9th C.C.A.) the Court stated:

> "Evidence of prior acts of misconduct is not admissible unless in some way relevant to the crime charged, and where entrapment is in issue evidence of prior crimes is not relevant unless it tends to prove that defendant was engaged in illegal operations in some way similar to those charged in the indictment."

See also:

Enrique v. U. S., 314 F. 2d 703 at 713-717.

In *Lutwak v. U. S.,* 73 S. Ct. 481 the Court stated:

> "Declarations stand on a different footing. Declarations of one conspirator may be used against the other conspirator not present on the theory that the declarant is the agent of the other, and the admissions of one are admissible against both under a standard exception to the hearsay rule applicable to the statements of a party (citing cases) but such declaration can be used against the co-conspirator only when made in the furtherance of the conspiracy. * * *
>
> Relevant declarations or admissions of a conspirator made in the absence of the co-conspirator, and not in furtherance of the conspiracy, may be admissible in a trial for conspiracy as against the *declarant's* participation therein. The Court must be careful at the time of the admission and by its instructions to make it clear that the evidence is limited as against the declarant only."

In *Erwing v. U. S.*, 296 F. 2d 320 (1961) (9th C.C.A.) the Court stated:

> "The general rule prevailing in this circuit is that when a defendant is on trial for a specific offense evidence of a distinct offense unconnected with that charged in the indictment is inadmissible."

In addition to the fact that the "other crimes and misconduct" went before the jury when the evidence showed that in fact there were no stolen cigarettes or illegal gold (R.T. 2234; R.T. 2216-2218; R.T. 2220-2222).

This testimony of the Government witness was based solely on suspicion, surmise and guesswork and had no basis in fact, and the testimony about the Bonds in no way was connected to Thomas nor made a part of the alleged conspiracy since Greene was acquitted on the conspiracy charge, the Government's theory of connecting up the Bonds to the conspiracy being extremely remote. At best, it merely showed the possible groundwork for an independent operation in the future and amounted to mere speculation.

After having presented before the jury the alleged misconduct consisting of testimony about illegal bonds, gold and cigarettes, the Assistant U. S. Attorney argued these "other crimes and misconduct" before the jury as bearing on the guilt of the defendants (R.T. 2629-2632; R.T. 2648-2649; R.T. 2653), and stated that a liquor violator was like a narcotic peddler (R.T. 2625; R.T. 2644).

Thereafter, the Court, in its instructions to the jury at R.T. 2683 instructed the jury about the existing intent, or readiness or the willingness to break the law wholly fails to limit the instruction to the crimes charged in the indictment but uses such general language so that the instruction would include the evidence of illegal bonds, gold and cigarettes.

Again at R.T. 2685 the Court instructed that the jury could consider "prior misconduct of a defendant of a similar nature, including his relationship with those agents in any and all matters, *and you may consider any other evidence* which would indicate his state of mind and bear on the question of his existing intent, readiness or willingness to commit *a crime.*

Again the Court allowed the jury to consider the testimony regarding the illegal bonds, gold and cigarettes which is in no way part of the crime charged in the indictment.

At R.T. 2687, the instruction again refers at line 7 to "a crime" and at line 12 refers to "other crimes" without ruling out, against Thomas, the evidence of illegal bonds and cigarettes which in no way was connected to Thomas (R.T. 241; R.T. 785-789; R.T. 188, 190; R.T. 2215).

This admission into evidence of other crimes is clearly prejudicial under the rule of the *De Jong* case and especially prejudicial since it was not part of the alleged conspiracy and yet imputed to Thomas.

III

THE EVIDENCE ESTABLISHES AS A MATTER OF LAW THE DEFENSE OF CONSENT BY THE GOVERNMENT TO THE ALLEGED CRIMES AND THE AGENCY OF THE DEFENDANT

The first meeting that could be considered the formation of a conspiracy was on February 8, 1964, at the Hyatt House where Becker, Thomas and Courtney met. At this time, the only inference that can be drawn from the evidence is that no still was in existence. No still was constructed until the latter part of 1964 (R.T. 56).

Further, the evidence is undisputed that a total of 105 gallons of alcohol was made and all 105 gallons were sold to the government. There is no evidence of any "independent" crime other than the ones committed at the inducement of the government agent Courtney.

In *Henderson v. U. S.,* 261 F. 2d 909 (1959) (5th C.C.A.) the defendant agreed to purchase drugs for an undercover agent who stated he and his wife were ill and needed the drugs. The defendant complied and purchased heroin for the government undercover agent. All the heroin was purchased by the government.

The Court held that the defendant acted not for herself but as the sub-agent of the government and, because acting for the government the agent was not guilty of any offense and neither was the defendant.

See also:

Adams v. U. S., 220 F. 2d 297 (1955) (5th C.C.A.)

In *Woo Wai v. U. S.,* 223 F. Rep. 412 (1915) (9th C.C.A.) the Court cited an example in the case where a detective for a railroad company "conspired" with defendant to rob a train. The conspiracy originated with the detective who induced the defendant to participate.

The Court, in the example, held that since the railroad had assented to the robbery, there was no trespass and no larceny.

In *U. S. v. Campbell,* 235 F. Supp. 190 (1964) (D.C. E.D. New York) the defendant was prosecuted for engaging in the business of receiving wagers without paying the imposed tax.

The evidence disclosed that defendant had received a series of wagers from internal revenue agents at their solicitation.

The Court held:

> "The great difference is that the agents' activities must serve to throw light on independently existing criminality and must not themselves be the constitutive elements of all the offense that is made to appear. The test of criminality is not the embittered and disdainful standard of Mark Twain's The Man that Corrupted Hadleyburg, the ability to withstand calculated temptation by the government, but the more useful standard of actual engagement in the criminality at the solicitation of others than the government; where that exists, the evidence of agents' activities is useful, but useful only as it proves criminality beyond that which consists solely in the immediate reciprocals of the agents' acts."

Under Title 26, Sec. 5214, the U. S. Government may purchase alcohol without the tax thereon having been paid.

It is the appellant's contention that the only inference that can be drawn is that Courtney had authority to buy alcohol on which the tax was not paid and that, since all of the alcohol was sold to the government agent, and no independent crime was disclosed, it must follow that since Courtney was a feigned co-conspirator, the defendant Thomas was, in fact, a sub-agent of the government and the government consented to the acts now complained of.

IV

THE DEFENDANT THOMAS DID NOT INTELLIGENTLY WAIVE HIS PRIVILEGE UNDER THE FIFTH AMENDMENT AGAINST SELF-INCRIMINATION

Thomas was indicted August 5, 1966 (C.T. 2) and trial in the matter commenced February 28, 1967 (R.T. 1).

At the time of the indictment and trial, the cases uniformly held that the requirement to buy stamps and register under the Revenue Laws, Title 19 U.S.C. did not violate the Fifth Amendment in the matter of self-incrimination as far as wagering stamps, and registration, and firearm stamps, and registration were concerned.

See:

U. S. v. Costello, Marchetti, et al., 352 F. 2d 848 (1965) (2nd C.C.A.);

U. S. v. Grosso, 358 F. 2d 154 (1966) (3rd C.C.A.);

Haynes v. U. S., 372 F. 2d 651 (1967) (5th C.C.A.)

See also:

U.S.C.A. Article V (1961-1967 Supp.) p. 332, notes 105, 105a.

While the instant case has been on appeal, the Supreme Court decided the cases of *Marchetti v. U. S.,* 88 S.Ct. 697; *Grosso v. U. S.,* 88 S.Ct. 709; and *Haynes v. U. S.,* 88 S.Ct. 722.

Appellant prays this Honorable Court to take judicial notice of the statutes of the State of California regarding the regulation of Alcoholic Beverages and the penalties as contained in Business and Professions Code, Sections 23300, 23301, and Revenue and Taxation Code, Sections 32201, 32552, 32553, 32554, and 32555.

It is true that the defendant Thomas did not raise the constitutional question against self-incrimination at the trial, but this appeared at the time to be an idle gesture due to the state of the federal law at that time.

However, the fact remains that to require Thomas to register an illegal still and become licensed to sell illegal spirits would place him in criminal jeopardy with the State of California since there is nothing in the Revenue Laws relating to liquor and spirits that

makes such registration and purchase of stamps confidential.

Appellant is well aware of the rule that ordinarily one cannot raise a question on appeal that was not made an issue in the trial Court.

However, under Title 28, U.S.C., Section 1291, the appellate Court has the power and authority to consider for the first time, on appeal, an occurrence after the decision appealed from either under the concept of "plain error" or to prevent a miscarriage of justice.

In *Abbot v. Bralove,* 176 F. 2d 64 (1949) the Court held that the Court of Appeals has the power not only to correct error in a judgment under review but to make such disposition of a case as justice required, and in determining what justice does require, the Court is bound to consider any change, either in fact or in law, which has supervened since the judgment was entered.

In *Kohatsu v. U.S.,* 351 F. 2d 898 (1965) C.A. Cal. the Court held that the defendant's claim that admission of evidence violated defendant's constitutional rights could be properly considered by the Court of Appeals despite lack of objection on constitutional grounds at the trial, particularly since a relevant United States Supreme Court decision followed defendant's conviction if defendant's rights were, in fact, violated.

Based upon the foregoing premises, appellant respectfully urges the Court to consider the constitu-

tional privilege of the appellant against self-incrimination under the Fifth Amendment.

CONCLUSION

It is respectfully submitted that the judgment of conviction should be reversed and the appellant discharged under Specifications of Errors I, III and IV or, in the alternative, that the matter be remanded for a new trial under Specifications of Errors I, II, III and IV.

Dated, Sacramento, California,
April 2, 1968.

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the Unites States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

LEONARD P. BURKE,
Attorney for Appellant.

No. 22,104, A, B

United States Court of Appeals

For the Ninth Circuit

MIKE A. THOMAS, *Appellant*, vs. UNITED STATES OF AMERICA, *Appellee.*	No. 22,104-B
JOHN BECKER, *Appellant*, vs. UNITED STATES OF AMERICA, *Appellee.*	No. 22,104-A
EARLE D. GREENE, *Appellant*, vs. UNITED STATES OF AMERICA, *Appellee.*	No. 22,104

Appeal from the United States District Court for the Northern District of California, Northern Division

BRIEF FOR APPELLEE

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Appeal from the United States District Court for the Northern District of California, Northern Division

BRIEF FOR APPELLEE

JURISDICTION

These are timely[1] appeals from judgments of con-

[1]Judgments were entered as to each appellant on May 12, 1967 and each appellant filed a notice of appeal pursuant to Rule 37(a)(2) F. R. Crim. P. on May 19, 1967.

viction in the United States District Court for the Northern District of California, Northern Division (now part of the Eastern District of California) for violations of Title 18 U.S.C. § 371 (Conspiracy—as to appellants Becker and Thomas); Title 26 U.S.C. § 5601(a)(1) (Possession of an Unregistered Distilling Apparatus—as to appellant Thomas); Title 26 U.S.C. § 5604(a)(1) (Sale Without Stamp of Distilled Spirits—as to appellants Becker, Thomas and Greene).

Jurisdiction in the District Court was based upon Title 18 U.S.C. § 3231. Jurisdiction in this Court is invoked under Title 28 U.S.C. § 1291.

STATEMENT OF THE CASE

Proceedings Below

By a four count indictment (Cr. No. 14748) filed on August 5, 1966, the appellants were charged as follows: Count I charged a violation of Title 18 U.S.C. § 371 (Conspiracy) against the appellants Thomas, Becker and Greene; Count II charged a violation of Title 26 U.S.C. § 5601(a)(1) (Possession of Unregistered Distilling Apparatus) against appellant Thomas; Count III charged a violation of Title 26 U.S.C. § 5604(a)(1) (Sale Without Stamp of Distilled Spirits) against appellants Becker and Greene; and Count IV charged a violation of Title 26 U.S.C. § 5604(a)(1) against the appellants Thomas and Becker. All appellants were arraigned and entered pleas of not guilty on September 14, 1966.

A jury trial was begun on February 28, 1967 before the Honorable Thomas J. MacBride, and on March 31, 1967 a verdict was returned by the jury finding appellants Becker and Thomas guilty on each count in which they were charged (i.e., Counts I, III, and IV as to Becker, and Counts I, II, and IV as to Thomas). Appellant Greene was acquitted on Count I and found guilty on Count III.

Post trial motions for judgments of acquittal and for a new trial under Rules 29 and 33, respectively, of the Federal Rules of Criminal Procedure were made by each appellant and denied by the Honorable Thomas J. MacBride on May 12, 1967. On the same date the appellants were sentenced as follows: Thomas was committed to the custody of the Attorney General for imprisonment for a period of 3 years on Counts I, II, and IV, the sentences to run concurrently. Becker was given an identical sentence as to Counts I, III, and IV. Greene was sentenced on Count III to a term of imprisonment for 3 years, the first 6 months to be spent in jail with the execution of the balance suspended and he was placed on probation for 5 years at the expiration of the jail term.

A stay of execution was granted as to each appellant and on May 19, 1967 each appellant was admitted to bail pending appeal.

Statement of the Facts

In September of 1962, Jack Courtney, a special investigator with the Alcohol and Tobacco Tax Division of the United States Treasury Department, assumed

the role of an undercover agent in an effort to penetrate an organization which was selling bootleg whiskey. In that guise he was introduced to appellants Becker and Thomas by an informer for the Oakland Police Department on September 5, 1962.[2] During the course of that meeting Becker and Thomas told Agent Courtney that if he wanted to deal with them he would have to be able to take delivery of 100 to 200 gallons a week. Courtney advised them he was in a position to accept whatever they could produce.[3] Later that same evening Becker took Agent Courtney to his home in Oakland where he gave Courtney a sample of their—i.e., Becker and Thomas'—bootleg whiskey.[4] The appellants Becker and Thomas also described their present still set-up to Agent Courtney at that time.[5]

On September 10, 1962, Agent Courtney purchased 8 gallons of illegal distilled spirits from Becker and Thomas.[6] As a result of the aforementioned activities of Agent Courtney, a still was located and raided on the property of appellant Thomas near Sacramento, California in October 1962[7] and Becker and Thomas were subsequently convicted for offenses similar to those charged in the instant indictment in the early part of 1963. Both appellants were sentenced to six

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[2]Reporter's Transcript, Vol. 3, pp. 664-666; Vol. 6, pp. 1731-1738.
[3]R.T., Vol. 3, p. 666.
[4]R.T., Vol. 3, pp. 667-668.
[5]R.T., Vol. 3, p. 669.
[6]R.T., Vol. 3, pp. 670-671.
[7]R.T., Vol. 3, pp. 672-673.

months in jail and were released from custody in approximately November 1963.

A few days after Becker was arrested in October 1962 Agent Courtney contacted him by phone while Becker was out on bail in an effort to determine whether his undercover identity had been compromised.[8] Becker manifested an unawareness of Courtney's true identity.[9]

Agent Courtney had no further contact with either Becker or Thomas until December of 1963 when he received a letter from Becker.[10] The letter from Becker to Courtney dated December 16, 1963 read as follows:

> "Dear Jack: Sorry I couldn't talk to you the last time you called, but I didn't want people to listen in on our conversation. I'm back in circulation now, and it's very important that I see you. Contact me at my office. I'm usually there from 8:00 a.m. to 7:00 p.m., six days. I'll enclose my card so you can contact me there. Like always, Johnnie."[11]

Becker had previously indicated to the Oakland Police Department informer in 1962 after the Sacramento still had been raided that he intended to continue the bootlegging venture when their then current problems subsided.[12]

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[8]R.T., Vol. 3, pp. 673 and 818 and 820.

[9]R.T., Vol. 3, p. 674.

[10]R.T., Vol. 3, p. 674 and Vol. 3, pp. 466-467, Defense Exhibit No. 3.

[11]R.T., Vol. 3, pp. 674-675, Defense Exhibit No. 3.

[12]R.T., Vol. 6, pp. 1737.

A business card of Becker's was enclosed in the aforedescribed letter and the phone call referred to therein related to the call from Agent Courtney to Becker in November 1962 when Courtney was attempting to determine if either Becker or Thomas was aware of his undercover identity.[13]

After receiving the letter of December 16, 1963, Agent Courtney called Becker and was advised by the appellant that it was very important for Becker and Thomas to meet with Courtney.[14] Thereafter, Courtney arranged to meet Becker and Thomas at the Hyatt House in San Jose, California on February 8, 1964.

At the meeting of February 8, 1964 Becker and Thomas informed the agent that they were going back into the bootlegging business and wanted to know if Courtney was still in a position to purchase their product in bulk quantities.[15] Becker and Thomas at that time indicated that they preferred to sell to one source only in order to reduce the risk of apprehension.[16] Additionally, they advised the undercover agent that he was to contact only Becker, that Thomas would be in charge of the still operation and to check periodically with Becker in order to ascertain how things were going.[17]

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[13]R.T., Vol. 3, p. 675.
[14]R.T., Vol. 3, p. 693.
[15]R.T., Vol. 3, pp. 694-695.
[16]R.T., Vol. 3, p. 695.
[17]R.T., Vol. 3, p. 696.

At a later meeting between the agent and Becker and Thomas at the Hilton Inn in San Bruno, California on May 27, 1964, the appellants indicated they were having some difficulty, expressed concern over the use of the telephone in their communications and devised a code to represent quantities of illicit spirits.[18]

In September 1964 Courtney received a letter from Becker (Government Exhibit C) in coded language indicating that a delivery of spirits was imminent.[19] In October 1964 the agent received another letter from Becker (Government Exhibit D) inquiring as to why he had not heard from Courtney and indicating in code that a delivery of spirits was waiting to be picked up.[20] A meeting was thereupon arranged in Richmond, California on October 22, 1964 and 10 gallons of illicit spirits were sold to Courtney for $100. At the aforesaid meeting Thomas told the agent that the delivery was less than expected because the individuals operating the still had "shorted" them.[21] Both Becker and Thomas remained silent as to where their still was located.[22]

On December 7, 1964 Agent Courtney received another letter from Becker (Government Exhibit F) wherein Becker indicated in code that another delivery of alcohol could be expected shortly.[23] During a

[18]R.T., Vol. 3, p. 697.
[19]R.T., Vol. 3, p. 700.
[20]R.T., Vol. 3, p. 703.
[21]R.T., Vol. 3, pp. 706-707.
[22]R.T., Vol. 3, p. 707.
[23]R.T., Vol. 8, p. 712.

phone conversation between Agent Courtney and Becker on January 6, 1965, Becker told Courtney that they were having difficulty because of flooding in Northern California and on January 11, 1965 told Courtney in a phone conversation that he needed a new still location since the old one had been washed out by the flooding of the Eel River.[24]

On March 3, 1965 the appellants Becker and Thomas met Courtney in Santa Rosa, California and sold him 35 gallons of illicit spirits for $450.[25] At that meeting Becker and Thomas asked the agent to find a ranch for them to set up their distillery. Courtney suggested a site in Nevada and the appellants agreed if he could find a suitable location for them.[26] On March 18, 1965 Courtney called Becker and advised him of a piece of Nevada property that the latter might be interested in for the purpose of setting up a distillery.[27]

Thereafter and on March 30, 1965, Agent Courtney met with Becker and Thomas at the Nugget Motel in Sparks, Nevada. At that meeting the aforementioned appellants advised Courtney that if they liked the proposed site they would move their still apparatus to Nevada.[28] After viewing the area, the appellants left Nevada and next met with the agent on April 8, 1965 at the Jack Tar Hotel in San Francisco.[29] At the

[24]R.T., Vol. 8, p. 715.
[25]R.T., Vol. 8, pp. 721-722.
[26]R.T., Vol. 8, p. 723.
[27]R.T., Vol. 3, pp. 724-725.
[28]R.T., Vol. 3, p. 726.
[29]R.T., Vol. 3, pp. 727-728, 729.

meeting in San Francisco Agent Courtney was introduced to a Bill Jones by Becker and Thomas. Jones was introduced to the agent as the still operator for the proposed new location in Nevada.[30] On April 19, 1965 Thomas advised the agent that he had checked out the location in Nevada and that he did not like it since he had observed "too many vehicles with long antennas" in the area and also because he felt safer in California.[31]

On June 13, 1965 Agent Courtney called Becker and was advised by Becker that he and Thomas needed sugar and that their present still location was approximately 60 miles north of Fresno.[32] The question regarding the acquisition of sugar had come up before when the appellants asked the agent if he could procure sugar for them at less than the retail price.[33] The agent subsequently made available 2,000 pounds of sugar for use by the appellants.[34]

At a meeting between the appellants Becker and Thomas and the agent, Courtney, at the El Rancho Motel in Sacramento on July 28, 1965, the appellants became suspicious of Courtney's true identity, but the agent managed to assuage their suspicions.[35] At that same meeting Becker and Thomas for the first time described in some detail the description and location of their still site and advised Courtney that they had

[30]R.T., Vol. 3, p. 730.
[31]R.T., Vol. 3, pp. 731-732.
[32]R.T., Vol. 3, p. 752.
[33]R.T., Vol. 3, p. 753.
[34]R.T., Vol. 3, p. 753.
[35]R.T., Vol. 3, p. 754.

a new still operator, Bill Jones having elected not to become involved.[36] Again, in October of 1965, Becker, during the course of a phone conversation with Courtney, revealed additional information about the still location.[37] During the aforementioned period of time, agents were attempting to locate the exact location of the still being operated by Becker and Thomas.[38]

On March 8, 1966 Agent Courtney met the appellant Greene for the first time. This meeting took place at the Del Webb Hotel in San Francisco and the appellant Becker was also there. Greene advised Courtney that certain stolen United States Treasury bonds previously received by Courtney from Becker were originally obtained by him (i.e., Greene) from the person who had stolen them. Greene also advised the agent that he expected Courtney to fence the bonds for them and that from his share of the proceeds he (Greene) would set up an additional still and produce alcohol which would be turned over to Becker and Thomas for sale to Courtney.[39] Becker then told Agent Courtney that he expected that Courtney would "take care" of him and Thomas from Courtney's share of the bond proceeds.[40]

Courtney received a letter from Becker on April 11, 1966 wherein the latter again advised him that they needed sugar badly.[41] On April 24, 1966 Thomas

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[36]R.T., Vol. 3, p. 755.
[37]R.T., Vol. 3, p. 759.
[38]R.T., Vol. 3, p. 760.
[39]R.T., Vol. 3, p. 792.
[40]R.T., Vol. 3, p. 792.
[41]R.T., Vol. 3, pp. 797-798.

and Glenn Curtice picked up the load of sugar previously referred to in Fresno, California.[42] After receiving the sugar Becker and Curtice were surreptitiously followed by other agents back to a farm located near Ceres, California.[43]

On May 28, 1966 Courtney received a telegram from Becker (Government Exhibit K) in coded language indicating that a load of distilled spirits was ready for delivery to Courtney.[44] On June 1, 1966 Courtney called Becker from Reno, Nevada and advised him that he would pick up the alcohol in a few days. During the course of the conversation Becker told Courtney that 60 gallons were ready and that he (Courtney) would have to pay more than originally agreed. Courtney refused and Becker then agreed to the price as previously fixed.[45] After a number of other phone calls from Courtney to Becker, it was agreed that appellant Greene would meet with Agent Bertolani[46] in Sacramento and make delivery of the alcohol.[47] Since Greene and Agent Bertolani had not

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[42]R.T., Vol. 2, pp. 517-518.

[43]R.T., Vol. 2, pp. 353-354. The delivery of the requested sugar to the farm in April 1966 confirmed the agents' suspicion as to the then present location of the appellants' still site. R.T., Vol. 2, p. 364. Additionally, no arrests were made at that time because of the suspicion that other unknown individuals were involved in the conspiracy and a still lingering doubt as to the exact location of the still. R.T., Vol. 2, p. 366.

[44]R.T., Vol. 3, p. 801.

[45]R.T., Vol. 3, pp. 801-802.

[46]Agent Bertolani was known to the appellants as Bill Costa and had previously operated in an undercover capacity when the load of sugar was delivered to Thomas and Curtice in Fresno. R.T., Vol. 2, pp. 517-518.

[47]R.T., Vol. 3, pp. 803-804; Vol. 2, pp. 518-519.

met each other before, a recognition signal was devised.[48] On June 4, 1966, Greene delivered 60 gallons of distilled spirits to Bertolani in Sacramento. Bertolani then placed a call to Agent Courtney at Becker's place of employment in Richmond, California advising Courtney that the delivery had been effected. Courtney thereupon paid Becker $780. Almost simultaneously thereafter Bertolani placed Greene under arrest, Courtney arrested Becker, and the still site near Ceres, California was raided.[49] Before Becker was arrested and before Courtney had revealed his true identity, Becker requested Courtney to look for yet another still location since the present site could not accommodate his 300 gallon still apparatus.[50]

The appellants Becker and Thomas had admitted to the undercover agent as early as September 1962 that they had sold non-tax-paid alcohol to the public prior to meeting Courtney. They indicated, however, that they preferred one buyer.[51]

The testimony adduced at the trial of this case established, inter alia, that the undercover agent posed as an underworld figure in order to gain the confidence of the appellants Becker and Thomas who were attempting to locate a syndicate connection in order to sell their bootleg alcohol.[52] The still site in Nevada was obtained and offered to the appellants after they

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[48]R.T., Vol. 3, pp. 803-804; Vol. 2, pp. 518-519.
[49]R.T., Vol. 2, pp. 527-529; Vol. 3, pp. 805-806; and Vol. 1, p. 146.
[50]R.T., Vol. 3, p. 805.
[51]R.T., Vol. 3, pp. 825-826; Vol. 4, p. 1015; and Vol. 8, p. 2115.
[52]R.T., Vol. 3, pp. 831, 664-665; Vol. 6, pp. 1731-1738.

had specifically requested the agent to obtain one for them.[53] The sugar which was provided the appellants was provided only after their continued requests.[54] The appellants were to bear the ultimate cost of any items furnished them by deducting said cost from the purchase price of the alcohol.[55] The significant reasons for the lengthy investigation in this case were the failure of the Government to locate the still sites being operated by the appellants Becker and Thomas[56] and the caution exercised by the appellants in their dealings with the undercover agent.[57] With regard to an offer of a still apparatus, the agent testified that he told the appellants Becker and Thomas that he could make arrangements to have a still apparatus sent out from the East if theirs was not satisfactory. The offer was declined by the appellants on the ground that their own apparatus was more than adequate.[58] Although the agent knew the appellants were on probation in 1963 as a result of a previous conviction for bootlegging, it was the appellant Becker who first contacted Courtney in 1963 advising the undercover agent that he was "back in circulation now."[59] Appellant Thomas was the only participant in the conspiracy known to Glenn Curtice and aided the latter

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[53]R.T., Vol. 3, pp. 715 and 723.

[54]R.T., Vol. 3, pp. 752, 753, 797-798.

[55]R.T., Vol. 4, p. 1016.

[56]R.T., Vol. 4, pp. 1017-1019.

[57]R.T., Vol. 2, p. 341; Vol. 3, p. 754; Vol. 4, pp. 1023, 1032, and 1037-1038.

[58]R.T., Vol. 4, p. 1043.

[59]R.T., Vol. 3, pp. 674-675; Vol. 8, p. 2114; Defense Exhibit No. 3.

in constructing the still apparatus and supplied the raw material for construction of the stills.[60]

ARGUMENT

I. RESPONSE TO APPELLANT THOMAS' ARGUMENTS.

A. There Was No Entrapment As A Matter Of Law And The Court Did Not Err In Denying Thomas' Motion For Judgment Of Acquittal.

It is fundamental that where there is any conflict in the evidence, the defendant is entitled to the defense of entrapment as a matter of law only if he establishes it beyond a reasonable doubt. If not, the question must go to the jury. *Masciale v. United States,* 356 U.S. 386 (1958); *Matysek v. United States,* 321 F.2d 246 (9th Cir. 1963). Thomas argues that since the government undercover agent posed as a gangster, offered to furnish a still site and operator, furnished 2,000 pounds of sugar and only received 105 gallons of alcohol over a 2½ year period, entrapment existed as a matter of law. The evidence, however, indicated that the agent assumed the role of a syndicate contact because that is exactly what Thomas and Becker were looking for in order to sell their alcohol to one source.[61] Additionally, the proposed still site in Nevada was offered to the defendants only after they had specifically requested the agent to obtain one for them.[62] The sugar also was provided only

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[60]R.T., Vol. 1, p. 56.

[61]R.T., Vol. 3, pp. 666, 694-695; Vol. 4, pp. 1731-1738; and Vol. 3, p. 831.

[62]R.T., Vol. 3, pp. 715 and 723.

after continued urgings by the defendants.[63] Providing a defendant with the necessary and requested means to commit an offense is not in itself entrapment. *United States v. Roett,* 172 F.2d 379 (3rd Cir. 1949) cert. den., 336 U.S. 960 (1949).

With respect to the lengthy period of time which elapsed from the receipt of Becker's letter in December 1963 until the apprehension of the defendants in June 1966, the evidence established that Becker and Thomas were having difficulty with their still and its location (one of which had been flooded out by the overflow of the Eel River); the defendants exercised caution in dealing with the agent and at one time suspected his true identity; and at no time until just prior to the arrests in this case did the government know of the exact whereabouts of the still and its location.

Thomas also contends that there is no evidence that he was engaged in any criminal activity between December 16, 1963 and late fall 1964 (Thomas' Opening Brief, p. 14). The facts indicate, however, that Thomas along with Becker met with the agent at the Hyatt House in San Jose in February 1964 and made it known at that time that he intended to get back in the bootleg business. Furthermore, he again met with the agent and Becker at the Hilton Inn in San Bruno in May of 1964 and advised the agent at that time that he was having some difficulty in starting up the new operation and assisted in devising the code that

[63]R.T., Vol. 3, pp. 752, 753, 797-798.

was subsequently used in their communications.[64] Both of the above meetings being in furtherance of the conspiracy alleged and constituting "criminal activity."

There is much evidence in this case establishing that the government agents merely went along with the criminal plan of the defendants. The defense of entrapment is not established as a matter of law by simply showing that particular acts were committed at the instance of government officials. *Sorrells v. United States,* 287 U.S. 435 (1932). As this Court pointed out in *Matysek v. United States, supra,* at 248: "Relevant to the issue [of entrapment] is the predisposition and willingness of the accused to commit the crime and the criminal design of the accused." There was an abundance of evidence establishing predisposition and willingness on the part of Thomas in this case, including a prior conviction for bootlegging.

The incidents cited in regard to "fixing" judges, arranging for abortions and bribing probation officers are taken out of context and truncated in Appellants' Opening Brief. The evidence with respect to those events established that they were all initiated by Becker who urged the agent to accomplish the requested acts as personal favors.

One commentator has pointed out that the defense of entrapment may be dissected into four constituent

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[64]See note 18, supra; also see Government Exhibits C and D.

elements.[65] First, a government officer or agent must instigate the offense; second, government agents must perform acts constituting inducement; third, the inducements offered by the government must cause the defendant's conduct; and finally, the criminal design must not originate in the mind of the defendant.[66] It is submitted that as to the first element, the offenses in the instant case were instigated by Becker's letter to the agent of December 16, 1963. The acts of inducement performed by the government agent were not offensive per se and the defendant was not corrupted by any solicitations of the government. Cf. *Whiting v. United States,* 321 F.2d 72 (1st Cir. 1963), cert. den., 375 U.S. 884 (1963). As to the third element, the government submits that any inducements offered by the government were not sine qua nons of the defendant's conduct. He should not be heard to complain that he was entrapped if there was no showing that the crimes were causally related to the inducements. See *Lopez v. United States,* 373 U.S. 427 (1963); and *Accardi v. United States,* 257 F.2d 168 (5th Cir. 1958); cert. den., 358 U.S. 883 (1958). The evidence in the case indicated that at the time of the initial meeting with the agent at the Hyatt House in San Jose in February 1964, the defendants had "already formed a design to commit the crimes charged" and were willing to do so. *United States v. Becker,* 62 F.2d 1007, 1008 (2nd Cir. 1933).

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[65]Orfield, "The Defense of Entrapment in the Federal Courts," 67 Duke Law J. 39 (1967).

[66]67 Duke Law J. at 44-45.

In light of the above, the government submits that there was ample evidence from which the jury could have and did infer the requisite state of mind on the part of Thomas.

B. There Was No Prejudicial Error In Allowing Testimony Of Other Misconduct Against Thomas.

On October 12, 1965 the undercover agent received a letter from Becker (Government Exhibit I) which read in part:

> "Something else you might make a buck on, so give this some thought, and I'd like to know by the middle of next week, because that's when he will contact me again. Anyhow, the story is that he has $40,000 worth of Government bonds to dispose of, and I was thinking maybe Mexico would be a good spot for them. If it can be worked, let me know what the breakdown would be for him and for us. I'll be in touch with you again as soon as I hear from the Greek."[67]

Early in the trial while counsel for Thomas was cross-examining a government agent the following colloquy took place:

> Q. Did you find anything to indicate that (Thomas) is a member of any gang of any kind?
>
> A. Yes, sir.
>
> Q. What kind of gang; give us the time, the place and the date, Officer?
>
> A. Well, it has been my experience that he has been associated with Mr. Greene and the other, Mr. Becker, and the other Defendants in this case. This is the only one.

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[67]"The Greek" was a sobriquet for Thomas; R.T., Vol. 3, p. 720.

Q. You say that your experience is that he has been associated with Mr. Greene?

A. Yes, sir.

Q. Therefore, that means that you ran a surveillance on Mr. Greene, to?

A. No, sir, it does not.

Q. Do you know anything at all about Mr. Greene?

A. Very little, sir.

Q. Know if he is a married man and resides in this community?

A. No, sir, I do not.

Q. Do you know if he has ever violated the law to your knowledge in his whole life?

A. Yes, sir.

Q. What did he do?

A. He was in possession of $50,000 worth of stolen United States Government Bonds.

Q. When was this?

A. This was in 1965, I believe.

Q. You believe. And you have a record on that; is that correct?

A. There is a record of that transaction.[68]

The Court thereafter gave a cautionary instruction on the above testimony.[69] However, testimony was later adduced by the government to the effect that a meeting was held on March 8, 1966 at the Del Webb Hotel in San Francisco at which the undercover agent, Becker and Greene were present. At this meeting Greene advised Courtney, the undercover agent, that he (Greene) had received the aforementioned

[68]R.T., Vol. 1, pp. 183-184.

[69]R.T., Vol. 1, pp. 239-240.

bonds from the person who had stolen them and that he had given them to Becker for transmittal to Courtney in order that the latter could "fence" the bonds for them. Moreover, Greene told Courtney that from his share of the proceeds he intended to set up a still, make alcohol and supply said alcohol to Becker and Thomas for delivery to Courtney. Becker acknowledged Greene's comments and stated that he expected Courtney to "take care" of Becker and Thomas from Courtney's share of the proceeds.[70]

The government contends that the above evidence was relevant and admissible against Thomas as showing another transaction in furtherance of the conspiracy. *Pinkerton v. United States,* 328 U.S. 640 (1946). However, even if it is assumed *arguendo* that the transaction regarding the stolen bonds (and the other evidence relating to misconduct) was not strictly in furtherance of the conspiracy, it was relevant to the intent and purpose of the defendants in engaging in the conspiracy—i.e., to acquire from whatever source possible additional funds to finance the bootleg operation. See, e.g., *United States v. Marchisio,* 344 F.2d 653, 667 (2nd Cir. 1965).

Additionally, the fact that Thomas was not present at the meeting between Courtney, Becker and Greene is immaterial since the declarations of one conspirator in furtherance of the objects of the conspiracy are admissible against his co-conspirators. *Carbo v. United States,* 314 F.2d 718, 735 (9th Cir. 1963).

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[70]R.T., Vol. 3, pp. 791-792, 781-782.

There was ample proof independent of the declarations of Becker and Greene that Thomas was connected with the conspiracy, e.g., the testimony of Courtney and Glenn Curtice.

With respect to stolen cigarettes and gold we invite the Court's attention to the fact that the testimony revealed that Thomas was present when those matters were discussed.[71]

The trial Court's rulings on the relevancy and admissibility of all the above evidence can be reviewed properly only if one considers the context in which those issues arose and in light of the defenses raised in this case and the direct testimony of the defendants Becker and Thomas.[72] It is respectfully submitted that the true test in each instance where evidence of other crimes or misconduct is offered is one of weighing the relevancy and value of the evidence against the danger of prejudice from its use, i.e., a calculus of relevancy. See: McCormick, *Evidence,* § 152 at 320 and especially § 157 at 331-332 (1954) where the author points out:

> "The second is that when the crime charged involves the element of knowledge, intent, or the like,[73] the state will often be permitted to show other crimes in rebuttal, after the issue has been sharpened by the defendant's giving evidence of

[71]R.T., Vol. 8, pp. 2168-2169, 2175-2178.

[72]See the trial Court's comments in ruling on the admissibility of this evidence at R.T., Vol. 8, pp. 2142-2143.

[73]This would seem to apply a fortiori where the defense of entrapment or coercion is raised and a searching inquiry into the state of mind of the defendant becomes imperative. Cf. *Sherman v. United States,* 356 U.S. 369 (1958).

accident or mistake, more readily than it would as part of its case in chief at a time when the court may be in doubt that any real dispute will appear on the issue.

"There is an important consideration in the practice as to the admission of evidence of other crimes which is little discussed in the opinions. This is the question of rule versus discretion. Most of the opinions ignore the problem and proceed on the assumption that the decision turns solely upon the ascertainment and application of a rule. If the situation fits one of the classes wherein the evidence has been recognized as having independent relevancy, then the evidence is received, otherwise not. This mechanical way of handling such questions has the advantage of calling on the judge for a minimum of personal judgment. But the problems of lessening the dangers of prejudice without too much sacrifice of relevant evidence can seldom if ever be satisfactorily solved by mechanical rules . . .

"Accordingly, some of the opinions recognize that the problem is not merely one of pigeonholing, but one of balancing, on the one side, the actual need for the other-crimes evidence in the light of the issues and the other evidence available to the prosecution, the convincingness of the evidence that the other crimes were committed and that the accused was the actor, and the strength or weakness of the other-crimes evidence in supporting the issue, and on the other, the degree to which the jury will probably be roused by the evidence to overmastering hostility."

Judge Browning recognized the above principle when, speaking for this Court, he stated in *Galvin and Ches-*

ney v. United States, ... F.2d ..... (No. 21,374, decided June 7, 1968), at page 5 of the slip sheet opinion:

> "But the task of 'balancing probative values against probative dangers' rested with the trial judge, and we are not prepared to say that his ruling exceeded the 'lee-way discretion' vested in the court in resolving problems of this kind."

Once Becker and Thomas raised the defense of entrapment (flavored with coercion) and concocted a relationship between the government agent and themselves in their testimony in a way such as to raise serious questions as to the true nature of that relationship, it became extremely relevant and probative to delve into the association in its totality. For only in such a fashion could the government establish their state of mind and rebut the contention that they were threatened, harassed, importuned, provoked and cajoled into committing the crimes charged in the indictment.

Thomas' reliance on *Devore v. United States,* 368 F.2d 396 (9th Cir. 1966) and *DeJong v. United States,* 381 F.2d 725 (9th Cir. 1967) is misplaced since the first did not involve an entrapment defense and in the latter the relevance-prejudice balancing scale was tipped heavily against the defendant.

C. There Was No Consent On The Part Of The Government To The Crimes Charged In The Indictment.

All the cases cited by Thomas in support of the proposition that the government consented to the commission of the crimes charged are entrapment

cases. As Orfield points out,[74] the kinship and the distinction between the consent defense and the entrapment defense is most readily seen in cases involving sexual offenses. In the former the consent of the government agent vitiates an element of the offense, while in the latter the defendant succumbs to the unlawful inducement of the agent. In the instant case Thomas was acting for himself, not as a subagent of the government. Thomas and Becker were producers and sellers of the illegal spirits sold to the government agent, not messengers or purchasing agents as was the case in *Adams v. United States,* 220 F.2d 297 (5th Cir. 1955) and *Henderson v. United States,* 261 F.2d 909 (5th Cir. 1959).

The evidence in the instant case established that the defendants authored the criminal design and harbored a disposition to commit the offenses for profit.[75] The offenses charged in the instant indictment were not assaults and thus the willingness of the agent to purchase the illegal alcohol is immaterial. Cf. *Guarro v. United States,* 237 F.2d 578, 582 (D.C. Cir. 1956).

D. The Holdings Of The Supreme Court In Grosso, Marchetti, And Haynes Are Inapplicable To The Instant Case.

It should be pointed out initially that only Count II of the indictment in this case charged a violation of Title 26 U.S.C. § 5601(a)(1) in that Thomas possessed a distilling apparatus setup which was not registered as required by Title 26 U.S.C. § 5179(a). The

[74]Orfield, "The Defense of Entrapment in the Federal Courts," 67 Duke Law J. 39 (1967) at p. 53, footnote 92.

[75]See notes 12, 15, 16, 45, 51, 52, 55, and 58, *supra.*

foregoing was the only so-called "registration statute" involved in this case.

Since the Supreme Court decisions in *Marchetti v. United States,* 390 U.S. 39 (1968), *Grosso v. United States,* 390 U.S. 62 (1968), and *Haynes v. United States,* 390 U.S. 85 (1968), a few courts have had occasion to examine the applicabiltiy of the Court's holdings to the registration requirement of Title 26 U.S.C. § 5179(a). In *United States v. McGee,* 282 F. Supp. 550 (M.D. Tenn. 1968) the District Court clearly distinguished *Marchetti, Grosso,* and *Haynes* and pointed out that the requirements of the federal still registration statute are not aimed at "a highly selective group inherently suspect of criminal activities," but rather are aimed at the entire liquor distilling industry as well as states and municipalities which engage in activities connected with distilled spirits. See *State of Ohio v. Helvering,* 292 U.S. 360 (1934).

In *United States v. Richardson and Wilson* (Criminal Case No. 2416-E), decided by the United States District Court for the Middle District of Alabama (Eastern Division) on April 23, 1968,[76] the Court again distinguished *Marchetti, Grosso,* and *Haynes* and observed that the statutory scheme with respect to liquor is not to compel suspected criminals

[76]As of the time of this writing the case has not been reported in the Federal Supplement. *Richardson and Wilson* was a case decided by the Court along with *United States v. Beason, et al.* (No. 2420-E), and *United States v. Davis* (No. 2422-E), all of which arose on motions in the District Court to dismiss the indictments.

to confess their crimes, but to protect a public interest in the collection of taxes.

We would also invite this Court's attention to *Cochran v. United States,* .... F.2d .... (10th Cir. 1968) in which a petition for certiorari was filed in the Supreme Court on April 3, 1968 (Sup. Ct. No. 1289) raising, *inter alia,* the question as to whether *Marchetti, Grosso,* and *Haynes* require remand to the district court for consideration of whether a prosecution for failure to pay the federal tax on moonshine whiskey violated the defendant's privilege against self-incrimination. See 36 LW 3445. On May 20, 1968, the Supreme Court denied certiorari. 36 LW 3438.

Furthermore, unlike the gambling cases, to register a still would not have incriminated Thomas under the law of the State of California because the operation of a still is not ipso facto illegal under California law, but rather the state merely requires registration also. That is, all the defendant had to do to avoid incriminating himself was to procure a state still license under the California Business and Professions Code, Secs. 23320(6) and 23367.

As to the other counts in the indictment, the government submits that no registration requirement exists wherein the defendant had to disclose any information, much less information which would have tended to incriminate him. The defendant's sole duty under the applicable statutes (i.e., Title 26 U.S.C. § 5205(a) and Title 26 U.S.C. § 5604(a)(1) was to refrain from transporting and selling the containers of liquor unless each bore the required tax stamp.

The omission of this duty—the performance of which would not have entailed a compulsory disclose—was the crime. In such circumstances it could hardly be said that the defendant was "confronted by substantial hazards of self-incrimination." *Marchetti v. United States,* at 61.

II. RESPONSE TO APPELLANT BECKER'S ARGUMENTS.

A. Venue Was Proper In The Instant Case And There Was No Error By Trial In The Old Northern District Of California.

Becker's argument in this regard was properly laid to rest by this Court in *Westover v. United States,* .....F.2d.....(9th Cir. No. 21,854, decided April 18, 1968). Judge Chambers therein pointed out that Title 18 U.S.C. § 3240 provides for the continuance of the old districts for the purpose of crimes committed before the effective date of a redistricting act. Here the offenses were committed prior to the redistricting date, the indictment was filed prior thereto, and the judge and jury sat as part of the old Northern District of California.

B. The Statements Of Becker Were Not Admitted In Violation Of His Constitutional Rights.

Becker argues, in substance, that since he was on probation at the time of the initial meeting with the undercover agent and for some time thereafter it was incumbent upon the agent to advise the defendant of his rights prior to engaging in conversation with him. The government submits that the above is an unwarranted extension of the *Miranda* doctrine and is unsupported by the cases. There was no custodial inter-

rogation within the purview of *Miranda* and the evidence established that the investigation continued in this case in order to locate the defendants' still apparatus. The agent was under no obligation to prevent the defendants from implicating themselves by interrupting the chain of events which they had set in motion. *Galvin and Chesney v. United States,* ..... F.2d ..... (9th Cir. No. 21,374, decided June 7, 1968, at page 6 of slip opinion). See also, *Lewis v. United States,* 385 U.S. 206 (1966), and *Osborne v. United States,* 385 U.S. 323 (1966).

C. There Was No Error In The Admission Into Evidence Of The Tape Recordings.

The first tape recording introduced into evidence was Government Exhibit B, a tape of a phone call from Agent Courtney to Becker on December 24, 1963.[77] The conversation was recorded by the use of an induction coil placed on the phone being used by Courtney and then connected by wire into a tape recorder.[78] The next recording played to the jury was a phone conversation between Becker and Courtney on January 28, 1964. The recorded conversation was contained on the same roll of tape as that of December 24, 1963 and was admitted into evidence as part of Government Exhibit B.[79]

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[77]This phone call was made after the receipt by Courtney of Becker's letter of December 16, 1963 wherein Becker advised Courtney that he (Becker) was "back in circulation" and that "it was very important that I see you." See note 11, *supra.*

[78]R.T., Vol. 3, p. 676.

[79]R.T., Vol. 3, pp. 821, 823, 824; the phone conversation between Becker and Courtney of January 28, 1964 was also recorded by use of an induction coil placed on the agent's phone. R.T., Vol. 3, p. 821.

The other two tapes which were admitted into evidence were Government Exhibits V-1 and V-2, recorded conversations between Agent Courtney, Becker and Thomas at the Hyatt House in San Jose on February 8, 1964 and at the Nugget Hotel in Sparks, Nevada on March 30, 1965, respectively.[80] The conversation at the Hyatt House was recorded by the use of a tape recorder and a subminiature radio transmitter. The transmitter was concealed in the agent's room and the conversation was broadcast to and recorded in an observation post located in a room adjoining the room occupied by the agent.[81] The conversation on the Nugget Hotel tape which was admitted into evidence (Government Exhibit V-2) and played to the jury was recorded by the use of a microphone concealed in the agent's room with a wire extending to a tape recorder in an adjoining room.[82]

With regard to the telephone conversations, the tapes were clearly admissible under the authority of *Lopez v. United States,* 373 U.S. 427 (1963); *Battaglia v. United States,* 349 F.2d 556, 559 (9th Cir. 1965); and *Todisco v. United States,* 298 F.2d 208 (9th Cir. 1961).

The tape recordings of the conversations between the agent, Becker and Thomas at the Hyatt House and Nugget Hotel were also clearly admissible under *Lopez, supra; Hoffa v. United States,* 385 U.S. 293 (1966); *Osborne v. United States,* 385 U.S. 323

[80]R.T., Vol. 8, p. 2131.
[81]R.T., Vol. 8, pp. 2115-2116.
[82]R.T., Vol. 8, pp. 2124-2125; Vol. 3, p. 751.

(1966); and *On Lee v. United States,* 343 U.S. 747 (1952). The conversations were in the agent's hotel room in both instances and there was no trespass. It is well settled that one who voluntarily communicates with another necessarily assumes the risk not only that the listener will remember and divulge the contents of the communication to others, but also that the communication may "be accurately reproduced in court, whether by faultless memory or mechanical recording." *Lopez, supra,* at 439.

Berger v. New York, 388 U.S. 41 (1967) is inapposite for the primary reason that the frailties in the New York statute were not present in the instant case. That is, there was reason to believe that a crime was being committed, and the entry into and conversations with the agent were voluntary. "Neither this Court nor any member of it has ever expressed the view that the Fourth Amendment protects a wrongdoer's misplaced belief that a person to whom he voluntarily confides his wrongdoing will not reveal it." *Hoffa v. United States,* 385 U.S. 293 at 302.

There is a problem, however, which has arisen in this case involving two conversations between Becker and Thomas outside the presence of Courtney. An electronic transmitting device was installed in the rooms jointly occupied by Becker and Thomas in the Hyatt House on February 8, 1964 and the Nugget Hotel on March 30, 1965. The conversations between the two which were recorded were abrupt, innocuous, and semi-unintelligible. They were not played to the jury and came to the government's attention for the

first time months after the trial of this case. The government takes the position that these tapes have no bearing on the convictions and we have advised counsel for each appellant of their existence and have offered to make them available for listening. We are at this writing awaiting the views of appellants' counsel as to whether they desire a full scale hearing on this issue in which case the government will move for a remand.

D. There Was No Entrapment As A Matter Of Law In This Case.

This issue was raised by Thomas and the government reiterates its argument in response to the appellant Becker. The evidence established that the undercover agent did no more than afford the appellants an opportunity for the continuation of a course of criminal conduct, upon which they had earlier voluntarily embarked. Cf. *Lopez v. United States,* 373 U.S. 427, 436 (1963).

The Government would also at this time respectfully invite the Court's attention to the well reasoned and definitive instruction which was given to the jury on the issue of entrapment in this case.[83]

E. There Was No Consent On The Part Of The Government To The Crimes Committed By The Appellants.

This issue again was raised by Thomas and the government reiterates its argument in response to the appellant Becker.

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[83]The entrapment instruction covers almost seven pages of transcript and is contained in R.T., Vol. 10, pp. 2682-2688.

F. There Was No Prejudicial Error In Allowing Testimony Of Other Misconduct Against Becker.

This issue was also raised by Thomas and answered in that portion of the government's Brief. However, the government again asserts that it is no answer to the problem to conclude that the questioned evidence was prejudicial. The fact standing alone that it showed that the appellants may have committed other crimes does not require its exclusion. See, *e.g., Reed v. United States,* 364 F.2d 630 (9th Cir. 1966).

This Court has recently observed that:

> "Since the evidence was properly received, it is no answer to say that it was 'prejudicial.' No doubt it hurt the defendants, but so would evidence in a murder trial that a witness saw the defendant shoot the deceased. That does not make it inadmissible on the ground that it is 'prejudicial.' "[84]

G. The Holdings Of The Supreme Court In Grosso, Marchetti, And Haynes Are Inapplicable To The Instant Case.

The Government reiterates its argument made in response to the appellant Thomas on this issue and would additionally point out that Becker was not charged under the registration count—i.e., Count II of this indictment.

III. RESPONSE TO APPELLANT GREENE'S ARGUMENTS.

A. The Testimony Relating To Greene's Possession Of Stolen Government Bonds Was Proper And Admissible In This Case.

The testimony adduced at the trial revealed that Greene told the undercover agent that he had received

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[84] *Suhl, et al. v. United States,* 390 F.2d 547 at 553 (9th Cir. 1968).

some stolen Government bonds and had given them to Becker for transmittal to the agent so that the latter could "fence" them. Furthermore, he told the agent that he intended to set up a still with his share of the proceeds and deliver the product from his still to Becker and Thomas for sale to the agent.[85]

Greene was charged in the indictment as a defendant and co-conspirator in Count I and as a joint defendant with Becker in Count III which alleged that Greene violated Title 26 U.S.C. § 5604(a)(1) by transporting, selling, and transferring tax unpaid distilled spirits. The government contends that the evidence relating to Greene's participation in the stolen bond venture was admissible to show his knowledge of the existence of the conspiracy and his knowing participation therein. Evidence of other crimes to establish knowledge and lack of mistake on the part of a defendant is proper and admissible. *United States v. Schaffer,* 266 F.2d 435 (2nd Cir. 1959); *Kowalchuck v. United States,* 176 F.2d 873 (6th Cir. 1949).

Additionally, it is respectfully submitted that the bond transaction was in furtherance of the conspiracy since the proceeds were intended to finance Greene's enlistment therein. See *Pinkerton v. United States, supra.* Again, however, even if we assumed *arguendo* that the transaction was not strictly in furtherance of the conspiracy, it was relevant to the intent and purpose of Greene in engaging in the conspiracy—i.e., to possess and have custody of a distilling appa-

[85]R.T., Vol. 3, pp. 791-792.

ratus not registered as required by law and to produce, deliver, and sell tax unpaid distilled spirits. See, e.g., *United States v. Marchisio,* 344 F.2d 653, 667 (2nd Cir. 1965).[86]

CONCLUSION

For all of the foregoing reasons we respectfully urge that the judgments below be affirmed as to each of the appellants.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES J. SIMONELLI
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United States of America.

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[86]The Court gave clear and exhaustive instructions to the jury with respect to the bond transaction and its relevance to Greene. R.T., Vol. 10, p. 2702.

No. 22105

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HERBOLD LABORATORY, INC. and MILTON HERBOLD,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' OPENING BRIEF

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No. 22105

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HERBOLD LABORATORY, INC. and MILTON HERBOLD,	)
Appellants,	)
vs.	)
UNITED STATES OF AMERICA,	)
Appellee.	)

APPELLANTS' OPENING BRIEF

Appeal by defendants in the court below from a judgment issuing an injunction in an action brought to recover civil penalties under Section 5(L) of the Federal Trade Commission Act (herein the Act), 52 Stats. 111, 15 U.S.C. §45(L) and imposing pecuniary penalties for violations of a final Cease and Desist Order issued by the Federal Trade Commission (herein either F.T.C. or the Commission).

I. JURISDICTIONAL STATEMENT

The District Court had jurisdiction of the penalty phase of the action under 28 U.S.C. §1345, if there was compliance with §16 of the Act (52 Stats. 116, 15 U.S.C. §56), otherwise not. Appellants contend that the Court had no jurisdiction, not only for non-compliance with Section 16, but also because the Act did not grant jurisdiction to District Courts to grant injunctive relief in civil penalty actions under Section 5(L) of the Act.

This Court has jurisdiction under 28 U.S.C. §1291.

II. STATEMENT OF UNDISPUTED FACTS

A. The Pleadings

The facts which are the basis of the judgments in the District Courts on those counts and points which are the subject of this appeal are undisputed. These facts are set forth below.

On May 7, 1951, the Commission issued a consent Cease and Desist Order (herein the Order) against Herbold Laboratory, Inc. and Milton L. Herbold pursuant to a complaint charging violations of Sections 12(a)(1) and 5(a) of the Act (15 U.S.C. §52(a) and §45(a)), in the dissemination in interstate commerce of false advertisements of "Herbold Pomade", a hair coloring product. That Order, so far as revelant here, provided that:

> "IT IS ORDERED that the respondents, Herbold Laboratory, Inc., a corporation, its officers, and Milton Herbold, individually and as an officer of Herbold Laboratory, Inc., their representatives, agents and employees, directly or through any corporate or other device, in connection with the offering for sale, sale or distribution in commerce of a cosmetic preparation designated as 'Herbold Pomade', or any preparation of substantially similar composition or possessing substantially similar properties, whether sold under the same name or any other name, do forthwith cease and desist from, directly or indirectly:
>
> "1. Disseminating or causing to be dissemi-

mails, or by any means in commerce as 'commerce' is defined in the Federal Trade Commission Act, any advertisement which represents, directly or by implication:

* * *

"(b) That said preparation will impart the former natural shade or color to gray, streaked, or faded hair.

* * *

"(e) That said preparation is a new, unique, or revolutionary product."

The Order was served on defendants and became final July 7, 1951.(C.T. 4).

Fourteen years later, on January 6, 1965, the United States filed a two count complaint against Milton Herbold only to recover $5,000.00 on each count for violation of Section 5(L) of the Act. The complaint alleged that Mr. Herbold violated the Order by offering for sale and selling in interstate commerce, under the name Hollywood Chemists, "Q. T. Color Balm", a hair coloring product possessing substantially similar properties to "Herbold Pomade". It alleged that the advertisements referred to represented that the product "would impart the former natural shade or color to gray, streaked, or faded hair." Count One alleged that about August 21, 1960, Mr. Herbold violated the Order by causing the dissemination in interstate commerce of an

in New York. Count Two alleged that he violated the Order by approving in November or December 1963, through an agent, an advertisement which appeared in the January 1964 issue of "Spencer Gifts" catalogue, and that the defendant thereby caused the dissemination in interstate commerce of catalogues containing said advertisement. Each Count demanded "Judgment against the defendant in the sum of $5,000.00," or a total of $10,000.00, together with plaintiff's costs and general relief. This was the sole relief sought.

Defendant answered, denying that he violated the Order as alleged.

Pretrial hearing was set for May 17, 1965.

On April 23, 1965, plaintiff filed a Motion for Leave to File an Amended Complaint, adding Herbold Laboratory, Inc. as a defendant.

On May 6, 1965, defendant Milton Herbold filed a Motion for Summary Judgment dismissing the Complaint as to him.

Plaintiff's Motion to Amend and defendant Milton Herbold's Motion for Summary Judgment were both heard on May 17, 1965 and both were granted. Summary Judgment dismissing the action as to Milton Herbold was entered on May 27, 1965. The basis of that Motion was that it was undisputed that Milton Herbold did not place, and had no knowledge of the placing of either of the advertisements in the newspaper or catalogue or of their dissemination in interstate commerce as alleged in the Complaint.

The relief sought by the Amended Complaint was the same as that sought by the original Complaint, to wit, the sum of $5,000.00 penalty in each Count.

file a Second Amended Complaint. This Motion, although opposed, was granted by the Court.

The Second Amended Complaint added four new counts against Herbold Laboratory, Inc. and included Milton Herbold individually as a defendant therein. These new counts alleged violations of the Cease and Desist Order by causing the dissemination in interstate commerce on February 10 and August 27, 1965 of advertisements of "Herbold Pomade" in the hereinafter named newspapers and dates. Each count alleged that the advertisements represented that the preparation "Herbold Pomade" 'would impart the former natural shade or color to gray, streaked, or faded hair." Count Three alleged that on February 10, 1965, defendants caused the dissemination on March 8, 1965 of an advertisement in the "Washington Post", a newspaper published in Washington, D. C., and on April 5, 1965, the same advertisement in the "Virginian Pilot", a newspaper published in Norfolk, Virginia. Count Four alleged that on February 10, 1965, the defendants caused the dissemination of an advertisement of "Herbold Pomade" in the "Evening Star" published in Washington, D. C. on March 23, and in the "Virginian Pilot" on March 23, April 20, June 1 and June 14, and in the "Richmond Times Dispatch", published in Richmond, Virginia, on March 23, April 20, May 20, and June 7, 1965, and in the "Beacon Journal", published in Akron, Ohio, on March 23, April 20, May 17, June 7, and June 22, 1965, of the same advertisement. Count Five alleged that on February 10, 1965, the defendants caused the dissemination of an advertisement of "Herbold Pomade" in the "Washington Post", published in Washington, D. C., on April 5 and May 4, 1965, and in

on March 8 and May 4, and in the "Virginian Pilot" on May 4, and in the "Beacon Journal" on March 8 and May 4, 1965. Count Six alleged that on August 27, 1965, the defendants caused the dissemination of an advertisement of "Herbold Pomade" in the "Evening Star", published in Washington, D. C., on September 21, October 4, October 18, and November 8, 1965, and in the "Washington Post" on September 27, April 12, October 26, and November 15, and in the "Virginian Pilot" on September 27, October 5, October 12, October 18 and November 2, 1965, and in the "Richmond Times Dispatch" on September 20, October 12, October 26, and November 8, 1965. It was alleged that each of these advertisements represented the preparation "Herbold Pomade" "would impart the former natural shade or color to gray, streaked, or faded hair", and that by the dissemination thereof in interstate commerce, the defendants violated the Cease and Desist Order. Each Count was followed by the prayer that plaintiff "demands judgment against defendants in the sum of $5,000.00." The sole relief prayed for in the Complaint was judgment against the defendants in the total sum of $30,000.00 on the six counts and for plaintiff's costs of suit and for "such other and further relief as this Court may deem just and proper." (C.T.9-10).

The defendants filed separate answers to these new counts.

B. The Motions For Summary Judgment

On September 16, 1966, each of the defendants filed a separate Motion for Summary Judgment. The Motion of Herbold Laboratory, Inc. was for Summary Judgment of dismissal on all six counts of the Second Amended Complaint and the Motion of Milton

inclusive. The basis of the Motions was that the advertisements referred to in the Second Amended Complaint did not represent that either "Q. T. Color Balm" or "Herbold Pomade" would "impart the natural shade or color to gray, streaked, or faded hair."

Plaintiff filed a Cross-Motion for Summary Judgment in its favor against Herbold Laboratory, Inc. on Counts Three, Four, Five and Six.

Following hearing, the Court granted the Motion of the plaintiff for Summary Judgment on Counts Three, Four, Five and Six and assessed penalties against Herbold Laboratory, Inc. of $500.00 on each of said four Counts and denied the Motions of both defendants for Summary Judgment in their favor. (C.T. 91).

On January 27, 1967, the Court filed Findings of Fact and Conclusions of Law on the Summary Judgment Motion, finding that the advertisements in Counts Three, Four, Five and Six did represent that "Herbold Pomade" would "impart the former natural shade or color to gray, streaked, or faded hair." It fixed the penalty at $500.00 on each of the four Counts against Herbold Laboratory, Inc., but deferred any judgment against it on Counts One and Two and on the remaining Counts as to the defendant Milton Herbold until the hearing and decision of the issues remaining. The findings were that "Herbold Pomade" represented that it "would impart the former natural shade or color to gray, streaked, or faded hair", that the corporation thereby violated the terms of the Cease and Desist Order, and that plaintiff was entitled to Summary Judgment against Herbold Laboratory, Inc. on Counts Three, Four, Five and Six and fixed a penalty on each of said Counts of $500.00, or a total of $2,000.00. The Court deferred

remaining issues in the case. (C.T. 88-91).

C. The Trial

At the trial of the case, the plaintiff produced two witnesses, who testified that in their opinion, Q. T. Color Balm did possess substantially similar properties to Herbold Pomade and the defendant Milton Herbold testified to the contrary. The Court found that Q. T. Color Balm did possess substantially similar properties to Herbold Pomade. Since this finding was predicated upon conflicting evidence, it cannot be said that it was clearly erroneous and therefore, the sufficiency of the evidence to support this finding is not raised on this appeal.

D. The Judgment

After the evidence on both sides was closed and the case was being argued, the plaintiff for the first time asked the Court to grant an injunction and the Court complied with this request.

The pleadings did not allege any facts showing any basis for injunctive relief. Neither of the three Complaints contained any allegation showing any basis or prayer for the issuance of injunctive relief and there is no finding of fact to support a judgment granting injunctive relief. The judgment in addition to providing for injunctive relief, provided that plaintiff recover from Herbold Laboratory, Inc. $250.00 on Count One and the same amount on Count Two, in addition to the $2,000.00 theretofore adjudged due on the Cross-Motion for Summary Judgment, and likewise assessed a penalty against Milton Herbold individually

total of $1,000.00. Judgment providing for an injunction reads as follows:

"IT IS FURTHER ORDERED that the defendant Herbold Laboratory, Inc., a corporation, its officers, and Milton Herbold, individually and as an officer of Herbold Laboratory, Inc., their representatives, agents and employees, directly or through any corporate device, in connection with the offering for sale, sale or distribution in commerce of a cosmetic preparation designated as "Herbold Pomade" or "Q-T Color Balm", or any preparation of substantially similar composition or possessing substantially similar properties, whether sold under the same name or any other name, are hereby djoined from, directly or indirectly:

"1. Disseminating or causing to be disseminated by means of the United States mails, or by any means in commerce as 'commerce' is defined in the Federal Trade Commission Act, any advertisement which represents, directly or by implication:

* * *

"(b) That said preparation will impart the former natural shade or color to gray, streaked, or faded hair.

* * *

"2. Disseminating or causing to be disseminated by any means, for the purpose of inducing or which is likely to induce, directly or indirectly, the purchase in commerce, as 'commerce' is defined in the Federal Trade Commission Act, of said preparation, any advertisement which contains any of the representations prohibited in paragraph '1' of this order." (C.T. 92-94).

Judgment was entered on March 10, 1967. Defendants filed separate Motions for New Trial and to Amend the Findings of Fact and Conclusions of Law and Judgment. These Motions were denied by the Court, which filed a Memorandum Opinion on May 1, 1967 (C.T. 102-109).

E. The Appeal

Notice of Appeal by both defendants was filed June 29, 1967. Both defendants appeal from the Judgment of Injunction enjoining both defendants on all six Counts as hereinabove set forth, it being noted that the injunction applies to Counts One and Two involving Q-T Color Balm, and that Milton Herbold is not a defendant in either of said Counts. The ground of appeal from the injunction is that the sole remedy provided for violation of a final Cease and Desist Order is the imposition of a pecuniary penalty, this remedy being deemed by Congress to be adequate. The appeal by both defendants from the monetary penalties imposed

on Counts Three, Four, Five and Six is upon the ground that the advertisements there involved did not represent that Herbold Pomade would impart the former natural shade or color to gray, streaked or faded hair, and upon the ground that no evidence was introduced to show that the newspapers there involved were disseminated in interstate commerce by the defendants or that the defendants caused such dissemination. The appeal as to the judgment is also upon the ground that there was no proof or finding of compliance with Section 16 of the Act (15 U.S.C. §56). (C.T. 110-112, 116-118).

III. QUESTIONS PRESENTED

The following questions presented on this appeal were raised in the manner stated:

1. Did the District Court have power under the Act to enjoin possible future violations of the final Cease and Desist Order when Congress had provided a specific legal remedy for violations of Cease and Desist Orders of an action to recover a pecuniary penalty for such violations?

2. If the District Court had jurisdiction to grant injunctive relief, was it error for the Court to grant such relief when there were no pleadings, prayer, evidence or findings to sustain such grant, the Court had ordered partial summary judgment for a pecuniary penalty only and had fixed the amount thereof, but had deferred entering final judgment therefor until the time of trial and determination of the remaining issues?

3. Did the District Court have subject matter jurisdiction in the absence of pleadings, proof and findings of compliance with Section 16 of the Act (15 U.S.C. §56), providing that

whenever the Commission has reason to believe that any person, partnership or corporation is liable to a penalty under Section 14 or under Sub-Section (1) of Section 5 of the Act (15 U.S.C. §56), it shall certify the facts to the Attorney General whose duty it shall be to cause appropriate proceedings to be brought for the enforcement of the provisions of such section or sub-section?

4. Do the advertisements, the subject of Counts Three, Four, Five and Six, represent that Herbold Pomade would "impart the former natural shade or color to gray, streaked or faded hair"?

5. Did the Court err in finding that the advertisements, the subject of Counts Three, Four, Five and Six, were disseminated in interstate commerce, when no evidence was introduced to prove that they were, and said finding was based solely upon the court taking judicial notice that the "Washington Post" and "Evening Star" are circulated in interstate commerce, but there was no evidence or finding that the specific issue of the publications which were the subject of said cause of action were, in fact, disseminated in interstate commerce?

The first and second questions above were raised by appellants on their motions for a new trial, this being the first opportunity they had to do so because the first mention that was made concerning the issuance of an injunction was in the argument being made by one of appellee's attorneys following the close of all of the evidence. None of the three complaints filed by appellee contained any allegations of facts which are

generally considered as essential prerequisites to the granting of injunctive relief, that is, no facts were alleged showing great or irreparable damage or injury, or lack of an adequate remedy at law, or that there was danger that if the injunction was not issued that the defendants would violate the Cease and Desist Order, or that they were threatening to do so. When the court ordered summary judgment on Counts Three, Four, Five and Six, it fixed the penalty as $500.00 on each of said Counts and concluded that "judgment in accord with these conclusions should be rendered at the time of the adjudication of the remaining issues in this case." (C.T. 91). No findings or conclusions whatsoever were made with respect to injunctive relief.

The third question above also arose on the motion for a new trial.

The fourth question above arises from the face of the advertisements which are the subject of the Third, Fourth and Fifth Counts. In their motions for summary judgment, the defendants filed affidavits and exhibits, consisting of advertisements of competitors all of which disclose that the advertisements in question do not represent that Herbold Pomade or the competitive products would impart the former natural shade or color to gray, streaked or faded hair, but represented that such products would cause hair to become young looking again, and to cause the person using the same to look younger by darkening the hair, and that it would have a natural looking color.

The fifth question above arose at the time of the trial because no evidence was introduced by the plaintiff to prove that any of the advertisements referred to in the Second Amended

Complaint had been disseminated in interstate commerce, and no showing was made on plaintiff's motion for summary judgment, which was granted by the court, and no finding was made in connection therewith that the newspapers containing such advertisements were, in fact, disseminated in interstate commerce.(C.T.88-91)

IV. SPECIFICATION OF ERRORS

Appellants specify and rely upon the following errors of the District Court in its findings and judgment:

1. The Court erred in enjoining appellants from the doing of the acts referred to in the judgment and in holding that it had statutory authority to issue injunctive relief, because Congress had provided an adequate remedy at law for the violation of final Cease and Desist Orders, viz., a civil action to recover a pecuniary penalty, and had granted the Courts of Appeal, but not the District Courts, the power to issue injunctive relief enforcing such final Cease and Desist Orders.

2. The Court erred in granting injunctive relief in the absence of a complaint, evidence and findings showing that plaintiff was entitled thereto when the Court had already ordered partial summary judgment in favor of appellee for a pecuniary penalty only and fixed the amount thereof, but deferred entering final judgment until the trial and determination of the remaining issues.

3. The Court erred in holding that Section 9 of the Act (15 U.S.C. §49) granting power to District Courts to issue writs of mandamus in certain cases was applicable to enforcing final Cease and Desist Orders, since Congress had provided the remedy

of an action at law to recover pecuniary penalties only for violation of such orders and the power of the District Courts to issue writs of mandamus had been repealed by Rule 81(b) of the Federal Rules of Civil Procedure.

4. The Court erred in rendering judgment against appellants on Counts Three, Four, Five and Six because it was without jurisdiction over the subject matter thereof for failure of the appellee to allege and prove that the Commission had complied with Section 16 of the Act (15 U.S.C. §56), by certifying to the Attorney General the facts.

5. The Court erred in holding that the advertisements, the subjects of Counts Three, Four, Five and Six, stated and represented that Herbold Pomade would "impart the former natural shade or color to gray, streaked or faded hair" and in holding that such advertissments were disseminated in interstate commerce.

V. SUMMARY OF ARGUMENT

The District Court had no statutory power under the Federal Trade Commission Act to grant injunctive relief, restraining possible future violations of final Cease and Desist Orders. Congress, by the Wheeler-Lea Amendment to the Act, enacted in 1938, amended Section 5 of the Act by adding thereto subsection L (15 U.S.C. §45(L)) to provide an adequate remedy at law for violations of final Cease and Desist Orders, viz., a civil action to recover a pecuniary penalty of $5,000.00 for each violation. The Act does not confer jurisdiction on District Courts to grant injunctive relief for violations of such Orders

but only grants jurisdiction to the Courts of Appeal to make orders enforcing such Cease and Desist Orders. If it be assumed arguendo that the District Court had general equity powers to grant injunctive relief for violations of final Cease and Desist Orders, it was error to do so in the instant case, where there were not only no pleadings, evidence or findings showing that plaintiff was entitled thereto, but the Court in granting summary judgment on Counts Three to Six had adjudged that plaintiff should recover pecuniary penalties only.

Section 9 of the Act (15 U.S.C. §49), granting District Courts power to issue writs of mandamus compelling compliance with certain orders of the Commission in aid of its investigatory powers, relied upon by the Court as authority for granting injunctive relief, not only does not apply to final Cease and Desist Orders, but confers a legal and not an equitable remedy but the power of District Courts to issue writs of mandamus was repealed by Rule 81(b) of the Federal Rules of Civil Procedure.

The District Court did not have subject matter jurisdiction in the absence of pleadings, proof and findings that the Commission had complied with Section 16 of the Act (15 U.S.C. §56) which provides that whenever the Commission has reason to believe that any person is liable to a penalty under certain sections of the Act, it shall certify the facts to the Attorney General whose duty it shall be to cause appropriate proceedings to be brought for the enforcement of the provisions of such Sections.

The advertisements, the subject of Counts Three, Four, Five and Six, do not represent that Herbold Pomade would impart

the former natural shade or color to gray, streaked or faded hair, and if said advertisements were disseminated in interstate commerce, they did not violate the final Cease and Desist Order.

The finding that the advertisements, the subject of Counts Three, Four, Five and Six, were disseminated in interstate commerce is not supported by any evidence introduced, and the dissemination in interstate commerce of the specific issues of the newspapers in which said advertisements appeared, was not the proper subject of judicial notice.

VI. ARGUMENT

A. The District Court had no power, statutory or otherwise, to grant injunctive relief, restraining possible future violations of the final Cease and Desist Order, because Congress had provided an adequate remedy at law by a civil action to recover a civil penalty of not more than $5,000.00 for each violation, and had vested the power to issue injunctive relief only in the Courts of Appeal.

Under the original Federal Trade Commission Act (38 Stat. 719), Cease and Desist Orders issued by the Commission were neither final nor self executing. If a person subject to such an Order failed or neglected to obey it, the Commission could apply to the appropriate Circuit Court of Appeals "for the enforcement of its order." Upon the filing of the application and the transcript of the record before the Commission, the Circuit Court of Appeals "shall have jurisdiction of the pro-

ceeding and of the question determined therein and shall have power to make and enter . . . a decree affirming, modifying or setting aside the order of the Commission." The party affected by the order of the Commission also had the right to file a petition for review of the Commission's order in the Circuit Court of Appeals and upon the filing of the transcript, that court had the same jurisdiction to affirm, set aside or modify the order of the Commission as in the case of an application by the Commission for enforcement of its order. (Sec. 5(c), 15 U.S.C. §45(c)).

The Circuit Court of Appeals had power to make and enter a decree enforcing the order of the Commission to the extent that it was affirmed "and to issue such writs as are ancillary to its jurisdiction or are necessary in its judgment to prevent injury to the public or to competitors pendente lite."

Section 5(d) (15 U.S.C. §45(d) provides that "upon the filing of the record with it the jurisdiction of the Court of Appeals of the United States to affirm, enforce, modify or set aside orders of the Commission shall be exclusive."

In Chamber of Commerce v. Federal Trade Commission (8 Cir. 1922), 280 Fed. 45, the court held that the jurisdiction of the Circuit Courts of Appeal was limited to the enforcement of the final orders of the Commission to cease and desist and that such jurisdiction was exclusive. This case was followed by the Court of Appeals for the Ninth Circuit in Crown-Zellerbach Corporation v. F.T.C. (9 Cir. 1946), 156 F.2d 927.

The statute did not provide any penalty for violation of the Commission's Cease and Desist Order. It was necessary for the Commission to institute a second proceeding, usually before the

Commission, and to prove a violation of the original order. The Commission would then apply to the Court of Appeals for an order enforcing its Cease and Desist Order.

In 1938, the Wheeler-Lea Amendment was enacted (52 Stat. 111) and this resulted in an entire change in the enforcement proceedings of the Act.

In F.T.C. v. Jantzen, Inc., (9 Cir. 1966), 356 F.2d 253, reversed on other grounds, 386 U.S. 228, 18 L.Ed.2d 11, this court reviewed the provisions of the original Act and the effect of the Wheeler-Lea Act in the following language:

> "No penalty attached to the violation of either type of order. In order to obtain an enforcing order in the Court of Appeals, a second violation had to be shown. This was done, as in this case, by the Commission's ordering an investigation, appointing a hearing officer, and, usually, holding a hearing. (See the Commission's Rules at 16 C.F.R. § 1.35.) If a violation was found, the Commission then sought enforcement in the Court of Appeals. No penalty attached to this second violation, other than the entry by the court of a decree enforcing the order. Such a decree had the force of an injunction, and, if thereafter the Commission found further violation, it could bring the respondent before the court for punishment for contempt.
>
> "Not surprisingly, this very clumsy and time consuming procedure was severely criticized,

and in 1938 the Congress responded by adopting the Wheeler-Lea Act, 52 Stat. 111, section 3 of which (52 Stat. 111-114) amended section 5 of the Federal Trade Commission Act. That section (3) states: 'Section 5 of such Act * * * is hereby amended to read as follows: * * *.' The amended section contains 12 paragraphs, designated (a) through (L). Paragraph (b) retains substantially the same provisions for the issuance of cease and desist orders as was contained in the old third paragraph. Paragraph (c), however, is different. It provides for a petition by the respondent to the Court of Appeals for review of the order. The petition must be filed within sixty days from the date of service of the order. The court has powers similar to those conferred by the old section, but with the added power to decree enforcement. In general, the new paragraph (c) is comparable to the old fifth paragraph of the section (38 Stat. 720). The former fourth paragraph, providing for a petition by the Commission, is omitted. Paragraphs (g), (h), (i), and (j) provide for the finality of Commission orders - either when the period in which to petition for review expires or, if there be such a petition, then within a fixed time after the completion of subsequent court and Commission proceedings. All of this is new, as is paragraph (L). It subjects violators of final orders to 'a civil penalty of not more than

$5,000 for each violation.' This has since been amended (64 Stat. 21, 1950) to provide that each separate violation shall be a separate offense, and, if the violation is a continuing one, each day of its continuance is a separate offense." (p.255)

And again at Page 256:

"If the order before us were an F.T.C. order, we would have no problem. The order would be final and enforcible via the civil penalty route, and the Commission would not be here."

In commenting upon subsection L of Section 5, the Supreme Court in the Jantzen case said:

"The apparent reason for this variance from the procedure of the Wheeler-Lea Act was because of the heavy penalties which the

Congress attached to the violation of final orders of the Commission under the Finality Act."

Section 5L of the Act (15 U.S.C. § 45L) as enacted as part of the Wheeler-Lea Act of 1938, provided that a person subject to a final Cease and Desist Order "shall forfeit and pay to the United States a civil penalty of not more than $5,000.00 for each violation, which shall accrue to the United States and may be recovered in a civil action brought by the United States." By further amendment in 1950, it was provided that each separate violation of such an order should be a separate offense except that in case of continuing failure or neglect to obey a final order, each day of continuance of such failure or neglect shall be deemed a separate offense.

As noted by the Supreme Court, supra, these amendments impose heavy penalties for violation of final Cease and Desist Orders. It is clear that in changing the entire procedure of the original Act with respect to Cease and Desist Orders, that Congress intended to and did provide an adequate remedy at law for the violation of a final Cease and Desist Order, which was an action to recover the civil penalty provided for in Section 5L. Although the Act is silent as to the court in which an action to recover the civil penalty should be filed, Section 1355 of 28 U.S.C. provides that District Courts shall have original jurisdiction of any action or proceeding for the recovery or enforcement of any fine, penalty or forfeiture, pecuniary or otherwise, incurred under any Act of Congress, but Congress with-

held from District Court jurisdiction the power to issue injunctions to enforce final Cease and Desist Orders. Instead of conferring jurisdiction in the District Court to grant injunctive relief, it conferred such jurisdiction upon the Courts of Appeal under the provisions of the Wheeler-Lea Act, and it provided in Section 5d that the jurisdiction of the Courts of Appeal to enforce those final Cease and Desist Orders of the Commission should be exclusive.

When Congress intended to confer upon District Courts the power to grant injunctive relief under the various statutes administered by the Federal Trade Commission, it was specific in conferring that power either upon the Courts of Appeal or the District Courts. Thus, under Section 13(a) of the Act (15 U.S.C. § 53), it conferred jurisdiction on the District Courts to issue temporary restraining orders and preliminary injunctions to "enjoin the dissemination or the causing of dissemination" of advertisements in violation of Section 12 "pending the issuance of a complaint by the Commission under Section 5." Section 12 deals with false advertisements in commerce to induce the purchase of foods, drugs, devices or cosmetics. Section 13 was added by the Wheeler-Lea Act and it is significant that although it conferred jurisdiction on District Courts to issue preliminary injunctions in this limited type of case, it did not confer such jurisdiction with respect to final Cease and Desist Orders.

Congress also conferred authority on the Commission to bring suits in the District Courts for temporary injunctions and restraining orders for violation of the Textile Fiber Productions Identification Act (15 U.S.C. § 70f), the Fur Products

Labeling Act (15 U.S.C. § 69g), the Wool Products Labeling Act (15 U.S.C. § 68e) and the Flammable Fabrics Act (15 U.S.C. § 1195). Each of these acts require a showing that a person is violating or is about to violate the act "and that it would be in the public interest to enjoin such violation" until a complaint under the Federal Trade Commission is issued and dismissed or a Cease and Desist Order made thereon has become final or is set aside by a court on review.

It is clear that there is no statutory authority in the Federal Trade Commission Act conferring jurisdiction on District Courts to issue injunctions to enforce final Cease and Desist Orders.

Congress deemed that the legal remedy of an action at law to recover the pecuniary penalty of not more than $5,000.00 for each violation to be an adequate remedy at law.

> "Where a remedy for any particular wrong or injury has been provided by statute, the general rule is that no relief in equity can be afforded in such case by injunction. Constitutional objections being eliminated, a court of chancery will not intervene merely to better such remedy as the legislature has deemed sufficient, and it has been said that the general rule is applicable although the provisions of the statute may conflict with the notions of natural justice entertained by a court of chancery."

43 C.J.S., p. 455, § 25, citing Morrison v.

Work, 266 U. S. 481, 69 L.Ed. 394;

Bowe v. Judson C. Burns, Inc., 137 F.2d 37.

"As the principal remedy afforded by courts of law for an injury is money damages, if such damages will constitute an adequate compensation for the injury threatened or inflicted, equity will not interfere by injunction. In such case plaintiff must resort to an action at law for the damages sustained."

43 C.J.S., p. 455, § 25.

In 1 High on Injunctions, Fourth Edition, § 29, it is said:

"Where a positive statutory remedy exists for the redress of particular grievances, a court of equity will not interfere by injunction and assume jurisdiction of the questions involved; nor will it enjoin proceedings under such statutory remedy, since such interference would place the judicial above the legislative power of the Government . . . And in the courts of the United States the objection to granting relief by injunction, that the party aggrieved has ample remedy at law, need not be taken in the pleadings, but may be enforced by the court sua sponte, since it goes to the jurisdiction of the forum."

Allen v. Car Co., 139 U.S. 658; Hoey v. Coleman,

In Morrison v. Work, supra, action was brought seeking an injunction to restrain the defendant governmental officials from doing certain acts which plaintiffs alleged deprived plaintiffs of their property in violation of the Constitution. It was alleged that the Secretary of Interior refused to allot any of the reservation lands to the Indians or to permit the Indians to select or receive allotments. The Supreme Court held that if any Indian who was entitled to an allotment requested the same, he had an adequate remedy at law to bring a suit against the United States to secure the allotment, and that this statutory remedy was sufficient to deny injunctive relief.

In United States v. Harris, 177 U.S. 305, 44 L.Ed. 780, an action was filed to recover penalties for alleged violation of laws relating to the transportation of live stock. The statute provided that the penalties should be recovered by civil action. The defendants were receivers for the railroad and the question was whether they were liable for the penalties. The Supreme Court held that the statute was penal and was, therefore, to be strictly construed and that it was for the legislature and not the courts to define an offense, and provide for its punishment.

In Bowe v. Judson C. Burns, Inc., supra, the plaintiffs, who were former employees of the defendant, sued the defendant corporation, its President, and a union and union officials, alleging that plaintiffs had been required to work in excess of the maximum number of hours provided for in the Fair Labor Standards Act without being paid adequate compensation. Plaintiffs filed a second action, alleging that they were being

threatened with expulsion from the union because of the first action they filed. In the second action, they sought an injunction to restrain the defendants from interfering with the prosecution of the first action and from discharging them. The court granted a motion to dismiss upon the grounds that injunctive relief under the Act could be granted only against an employer and that the union was not an employer (46 F.Supp. 745). On appeal, the Court of Appeals held that the definition of the word "person" contained in the Act was broad enough to include a union but it also held that the sole remedy of an employee was to recover back wages and liquidated damages, and that injunctive relief could not be granted in a suit filed by employees, but could only be granted in an action brought by the Administrator.

In Utah Fuel Co. v. National Bituminous Coal Commission, 101 F.2d 426, affirmed 306 U.S. 56, orders of the National Bituminous Coal Commission were involved. The Act contained no express provision for injunctive relief. It did provide that the Courts of Appeal should have exclusive jurisdiction "to enforce, set aside or modify orders of the Commission." The court held that injunctive relief was not the proper remedy because the statute made adequate provision for judicial review, thereby providing an adequate remedy at law.

In the present case, Congress has provided that the Courts of Appeal shall have exclusive jurisdiction to enforce Cease and Desist Orders. It has provided that for violation of such orders, a pecuniary penalty for each violation is an adequate remedy. Under the well established rule that proceedings in equity for injunctions cannot be maintained where the complain-

ing party has an adequate remedy at law (Black River Valley Broadcasting v. McNinch, 101 F.2d 235; Smith v. Duldner, 175 F.2d 629), the District Court was without power to grant injunctive relief. In considering this question, it should be kept in mind that District Courts are courts of limited jurisdiction and have only the power and the jurisdiction conferred upon them by statutory enactments of Congress (United States v. Parkinson, 135 F.Supp. 208, affirmed 240 F.2d 918). On appeal in this case, this court held that the Federal Food, Drug and Cosmetic Act had provided three specific powers, consisting of criminal prosecution, seizure and injunction, and that the "grant of such specific powers would be indicia of the denial of more extensive authority."

B. It was error for the Court to grant injunctive relief in the absence of pleadings, evidence and findings showing that plaintiff was entitled thereto, including a showing of equity jurisdiction.

District Courts are Courts of limited jurisdiction. They must find their jurisdiction in express provisions of Federal statutes.

Sheldon v. Sill, 49 U.S. 441, 449; 12 L.Ed. 1147, 1151;

Chicot County Drainage District v. Baxter State Bank, 308 U.S. 371; 84 L.Ed. 329;

Schroeder v. Freeland, 188 F.2d 517;

Gillis v. California, 293 U.S. 62, 79 L.Ed. 199;

A party seeking to invoke the jurisdiction of a Federal court must demonstrate that the case is within the jurisdiction of that court. The presumption is that the court lacks jurisdiction in a particular case unless plaintiff has demonstrated that jurisdiction over the subject matter exists.

Turner v. President etc. of the Bank of North America, 4 Dall. 8, 1 L.Ed. 718.

To overcome the presumption of lack of jurisdiction, facts must be affirmatively alleged, disclosing jurisdiction.

Bingham v. Cabot, 3 Dall. 382, 1 L.Ed. 646.

Rule 8(a) F.R.Civ.P. provides that a pleading setting forth a claim for relief must contain "a short and plain statement of the grounds upon which the court's jurisdiction depends." The Complaint alleged that jurisdiction was under 28 U.S.C. § 1345 (C. T. 2). That section provides that District Courts shall have original jurisdiction of all civil actions commenced by the United States. This section does not grant power to District Courts to grant injunctive relief in proceedings to recover civil penalties for violation of final Cease and Desist Orders.

In the absence of statute providing for statutory injunctions where the public interest may be affected, it is a rule of general application that a pleading seeking injunctive relief must allege facts, not only showing jurisdiction, but also, that the acts sought to be enjoined will in all probability be committed by the defendant unless he is restrained, and that

the acts committed will result in substantial injury to the plaintiff, that a refusal to grant the injunction will result in irreparable injury to the plaintiff, and that plaintiff does not have an adequate remedy at law. The Complaint should contain a prayer specifically praying for injunctive relief, including a description of the injunctive relief sought.

43 C.J.S., (Injunctions), § 182, pp. 857-867.

See cases cited in 14-A Cyc. Fed. Proc. §§ 73.11, 73.12 and 73.13.

"The basis of injunctive relief in the Federal courts has always been irreparable harm and inadequacy of legal remedies."

Beacon Theaters v. Westover, 359 U.S. 500, 3 L.Ed.2d 988, at 995;

Pennsylvania v. Wheeling & B. Bridge Co., 13 How 518, 561, 14 L.Ed. 264, 267.

Enelow v. New York Life Insurance Co., 293 U.S. 379, 74 L.Ed. 440.

In the instant case, there are no allegations in the Complaint disclosing that any of the defendants will, in all probability, commit any of the acts alleged unless restrained from so doing, or that the acts will result in substantial injury to the plaintiff. The Court made no finding that either of the defendants would in all probability commit any of the acts alleged unless restrained, or that irreparable injury to plaintiff would result. No facts are alleged and there are no findings

that plaintiff does not have an adequate remedy at law or that a refusal to grant an injunction would result in irreparable injury to the plaintiff. The Complaint does not contain any prayer for injunctive relief.

Since Congress has provided an adequate remedy at law for violations of the final Cease and Desist Order, it is doubtful that the Court could grant injunctive relief even if the Complaint did contain the requisite allegations of jurisdiction, threatened injury, irreparable damage, inadequate remedy at law, and a prayer for injunctive relief.

In the instant case, the only relief sought by the prayer was the imposition of a pecuniary penalty. An injunction will not ordinarily be granted under a prayer for general relief. 43 C.J.S., pp. 866-867.

In ordering summary judgment in favor of the plaintiff and against the defendant corporation on Counts Three, Four, Five and Six, the court fixed a penalty of $500.00 on each Count or a total of $2,000.00. (C.T. 91).

The court did not by such order grant any injunctive relief. Instead, the court ruled that since issues were raised as to the responsibility of Milton Herbold for the advertisements, the subject of Counts Three, Four, Five and Six, summary judgment would not be granted as to him on those Counts. The order provided, however, that "judgment in accord with these conclusions should be rendered at the time of adjudication of the remaining issues in this case." (C.T.91:23). Since there were multiple claims as well as multiple parties, this order

was proper under Rule 54(b) F.R.Civ.P. Under these circumstances it would seem clear that the final judgment entered should have been limited to a judgment for the pecuniary penalties fixed by the order granting partial summary judgment as to Counts Three, Four, Five and Six against the defendant corporation.

Milton Herbold individually was not a defendant in Counts One and Two, involving the dissemination of two advertisements of the product "Q. T. Color Balm". Despite this fact, the injunction applies to him with respect to this product.

We respectfully submit that if the Court had equity jurisdiction in this action, it was error to grant injunctive relief in the absence of pleading, prayer, evidence and findings establishing plaintiff's right thereto.

C. The Cases Relied Upon By The District Court As Authorizing Statutory Equitable Relief Are Not In Point Because In Each Such Case, The Statute Specifically Authorized The Equitable Remedy Of Injunction.

The Court in its Memorandum Opinion (C.T.104), cited and relied upon Mitchell v. DeMario Jewelry, Inc., 361 U.S. 288, 4 L.Ed.2d 323, which in turn cited and relied upon the case of Porter v. Warner Holding Co., 328 U.S. 395, 90 L.Ed. 1332, as authorizing the District Court to grant injunctive relief.

Porter involved Section 205(a) of the Emergency Price

Control Act, which specifically authorized the Administrator to apply to the Court "for an order enjoining such acts or practices, or for an order enforcing compliance with such provisions, and upon a showing by the Administrator that such person has engaged or is about to engage in any such acts or practices a permanent or temporary injunction, restraining order, or other order shall be granted without bond." The Administrator filed an action alleging that defendant was collecting over-ceiling rents from tenants and praying for an injunction restraining the defendant from collecting over-ceiling rents. By amendment, the Administrator sought an order requiring the defendant to offer to refund to the tenants the excess rents collected. The Supreme Court held that in seeking an injunction to enjoin defendant from committing acts and practices made illegal by the Act, the Administrator was invoking the equitable jurisdiction of the District Court which was specifically conferred by the statute. This statutory equitable jurisdiction carried with it all other inherent equitable powers, including the power to grant a mandatory injunction ordering restitution of the over-ceiling rents. The court further held that the restitution order was also authorized as an "other order" specifically authorized by the statute. The distinction between the Porter case and the instant case is obvious. The Federal Trade Commission Act does not grant jurisdiction to District Courts to enjoin violations of the Act or to issue "other orders". That Act grants exclusive jurisdiction only to the Courts of Appeal to enforce orders of the Commission.

The DeMario case, supra, is similarly distinguishable.

That was an action brought by the Secretary of Labor under the Fair Labor Standards Act of 1938 to enjoin an employer from violating Section 15(a)(3) of that Act, by not paying the correct amount of wages. Section 17 of the Act, 52 Stat. 1069, 29 U.S.C. §217, provided that 'the District Court . . . shall have jurisdiction, for cause shown, to restrain violations of Section 215 of this Title.' The court, relying upon the Porter case, held that the statute specifically granted the District Courts the equitable power of injunction to restrain violations of the Act and that this grant carried with it all powers of a court of equity including the power to order the defendants to pay the employees the correct amount of wages due to them, including reimbursement for loss of wages caused by unlawful discharge or other discrimination. Here again was a statute specifically conferring on the District Court the power to grant injunctive relief. The Federal Trade Commission Act confers no such power upon the District Courts with respect to final Cease and Desist Orders.

Other statutes specifically conferring such equitable jurisdiction in similar or almost identical language to the statutes involved in Porter and DeMario are referred to in U.S. v. Parkinson, 135 F.Supp. 208, viz., the Fair Labor Standards Act, 29 U.S.C., §201-209, the Food, Drug and Cosmetic Act, 21 U.S.C. §301-392, and the Sherman Anti-Trust Act. In Parkinson, the court held that in an action seeking an injunction under the Food, Drug and Cosmetic Act, the court was not authorized to order refunds to be made to purchasers of the product involved. The court pointed out that the basic differences between the statutes

involved in the Porter case and the Food, Drug and Cosmetic Act was that in the former, one of the purposes was to prevent landlords from enriching themselves by charging over-ceiling rents. The same principle would apply to the DeMario case, where one of the purposes is to prevent employers from underpaying their employees and thereby enriching themselves. However, the purpose of the Food, Drug and Cosmetic Act is different.

On appeal, this court in the Parkinson case expressly approved of the Parkinson District Court decision by Judge James M. Carter in the following language:

> "In a sound and able opinion, Hon. James M. Carter, United States District Judge, analyzed the problem, reviewed the statutes and determined that the particular enactment did not confer jurisdiction upon the United States District Courts to make such an order. With this opinion we agree, and the conclusions thereof we affirm. The jurisdiction of the District Court must be found in the language and implications of the particular statute." (240 F.2d 918, 919).

Referring to the powers granted under the Food, Drug and Cosmetic Act, this court at page 920 said:

> "The Congress granted three specific powers by this Act. The first was the power to bring criminal prosecutions for violations. The second permitted seizure of drugs proscribed in interstate commerce. The third empowered the courts to

restrain violations. Ordinarily, grant of such specific powers would be indicia of the denial of more extensive authority."

And again, at Page 922, this court said:

"When Congress authorizes the enforcement by an administrative body of rules, regulations or orders promulgated by it, the history of equity and the Court of the Star Chamber in this type of litigation should not be forgotten. The use of the extraordinary remedies of equity in governmental litigation should never be permitted by the courts unless clearly authorized by the statute in express terms. Anything which savors of a penalty should not be permitted unless Congress has expressly so provided, since the spirit of equity abhorred such punitive measures."

The learned District Judge in the instant case recognized that the Federal Trade Commission Act did not specifically confer jurisdiction upon District Courts to grant injunctive relief with respect to final Cease and Desist Orders (C.T.104). He quoted, however, from the fourth paragraph of Section 9 of the Act, 15 U.S.C. § 49, which provided that upon application of the Attorney General at the request of the Commission, District Courts of the United States "shall have jurisdiction to issue writs of mandamus commanding any person or corporation to comply

with the provisions" of certain sections of the Act "or any order the Commission made in pursuance thereof."

Not only is mandamus not an equitable remedy, but the power to issue writs of mandamus was denied to the District Courts by Rule 81(b) of the Federal Rules of Civil Procedure. In addition, the history of Section 9 of the Act clearly demonstrates that it was not intended to apply to final Cease and Desist Orders, because Congress had vested exclusive jurisdiction in the Courts of Appeal to make and enter orders enforcing compliance with such final Cease and Desist Orders.

Mandamus is a common law legal remedy although its issuance is largely controlled by equitable principles.

Duncan Townsite Co. v. Lane, 245 U.S. 308, 62 L.Ed. 309;

Heine v. Board of Levee-Commissioners, 19 Wal. 655, 22 L.Ed. 223;

U. S. ex rel Greathouse v. Dern, 288 U.S. 352, 77 L.Ed. 1250;

Snow v. Roche (9 Cir.1944), 143 F.2d 718;

Doehler Metal Furniture Co. v. Warren, 129 F.2d 43.

Since mandamus is a legal rather than an equitable remedy, injunctive relief will ordinarily not be granted where the mandamus remedy is available. (43 C.J.S. 456).

Rule 81(b) of the Federal Rules of Civil Procedure provides that writs of mandamus are abolished and that relief heretofore available by mandamus may be obtained by appropriate action or by appropriate motion under the practice prescribed in the rules.

28 U.S.C. § 2072, empowering the Supreme Court to prescribe rules of practice and procedure for the District Courts in civil actions, provides that "all laws in conflict with such rules shall be of no further force or effect after such rules have taken effect." It would seem to follow, therefore, that Rule 81(b) supersedes all Acts of Congress relating to writs of mandamus in conflict with the rules.

For these reasons, not only does Section 9 of the Act, authorizing District Courts to issue writs of mandamus, not provide an equitable remedy, but if it did, the power to issue such writs was repealed and superseded by Rule 81(b) F.R.Civ.P.

An analysis of Section 9 of the Act (15 U.S.C. § 49), discloses that it was not intended to apply and does not apply to final Cease and Desist Orders issued by the Commission.

Section 9 has remained unchanged since it was enacted in 1914. The first three paragraphs of that section provide that for the purposes of the Act, the Commission or its duly authorized agent shall have access to, for the purpose of examination, and the right to copy, any documentary evidence of any corporation being investigated or proceeded against, the power to require by subpena the attendance and testimony of witnesses and the production of documentary evidence relating to any matter under investigation. The attendance of witnesses may be compelled by subpena and disobedience thereof may result in the Commission invoking the aid of the United States courts to require the attendance of the witnesses. District Courts are empowered to issue an order requiring corporations and persons to appear

before the Commission or produce evidence, in case of their contumacy or refusal to obey any subpena issued to them, and to punish failure to comply with such a court order as contempt. The fourth paragraph, relied upon by Judge Gray, provides that "upon the application of the Attorney General of the United States, at the request of the Commission, the District Courts of the United States shall have jurisdiction to issue writs of mandamus commanding any person or corporation to comply with the provisions of this Act or any order of the Commission made in pursuance thereof." The remaining paragraphs deal with testimony by deposition, witness fees, and the granting of immunity to witnesses with respect to testimony which may tend to incriminate them.

As noted above (P. 17), at the time of the enactment of this Section in 1914, Section 5(c) of the Act provided that if a person subject to the order of the Commission failed or neglected to obey the same, the Commission might apply to the Circuit Court of Appeals of the United States "for the enforcement of its order", the Court of Appeals was granted jurisdiction of the proceeding and to make its own decree affirming, modifying or setting aside the order of the Commission. So also, any party required by the order of the Commission to cease and desist from doing certain things had the right to petition the Court of Appeals for a review of the Commission's order and that court had the same jurisdiction to affirm, set aside or modify the order as in the case of an application by the Commission to enforce the order. Section 5(d) provided that "the jurisdiction of the Court of Appeals of the United States to affirm, enforce,

modify or set aside orders of the Commission shall be exclusive." Since the Circuit Courts of Appeal were vested with exclusive jurisdiction to enforce final Cease and Desist Orders of the Commission, it follows that the Congress did not, by empowering District Courts to issue writs of mandamus, intend that that provision should apply to final Cease and Desist Orders as to which it had vested exclusive jurisdiction in the Circuit Courts of Appeal.

Under this view of Section 9 of the Act, the provision with respect to writs of mandamus applies only to commanding compliance with orders of the Commission made pursuant to the first three paragraphs of Section 9, with investigatory proceedings being held and conducted by the Commission, that is, to compel corporations to grant access to their records to agents of the Commission, to compel the attendance of witnesses, and the production of evidence on orders other than final Cease and Desist Orders. This is the construction of Section 9 made by the Court of Appeals for the Eighth Circuit.

In Chamber of Commerce, etc. v. Federal Trade Commission (8 Cir. 1922), 280 Fed. 45, the Commission had filed a complaint against the Minneapolis Chamber of Commerce, its officers, board of directors, and others, charging that from a preliminary investigation made by the Commission it appeared that the Respondents were using unfair methods of competition in interstate commerce, in violation of the F.T.C. Act. The Respondents made a number of motions before the Commission, all of which were denied. Respondents then filed a petition in the Circuit Court of

Appeals to set aside the order of the Commission denying their motions. In dismissing the petition for lack of jurisdiction, the court said:

> "The act itself clearly specifies when the jurisdiction of the Circuit Courts of Appeals may attach and to what extent that jurisdiction may be exercised. The power of the court is limited to the enforcement of the final orders of the commission to cease and desist, upon the application of the commission, and to review of such orders at the request of the party against whom such orders are made, and in such cases it has power to enforce, affirm, modify or set aside as it may deem proper. Immediately after these powers and duties are set forth in section 5 of the act this clause occurs:
>
> "'The jurisdiction of the Circuit Court of Appeals of the United States to enforce, set aside, or modify orders of the Commission shall be exclusive.'
>
> "Manifestly this refers to the specific powers just previously recited, and this is made still more apparent by the clause which next follows, wherein it is said:
>
> "'Such proceedings in the Circuit Court of Appeals shall be given

precedence over other cases pending therein, and shall be in every way expedited.'"

The court then considered the power of District Courts conferred by Section 9 and after quoting the fourth paragraph thereof, said:

"The final language of this clause is very broad, but we are convinced that it is intended to refer only to orders of the nature of such as are involved in paragraph B of section 6, which empowers the commission to require, by general and specific orders, certain corporations to file specified reports and answers under oath or otherwise. We do not think this language was intended to give the District Court jurisdiction over orders such as that now before us."

This case was cited and followed by the Circuit Court of Appeals for the Ninth Circuit in Crown-Zellerbach Corporation et al v. F.T.C., 156 Fed.2d 927.

The trial court in the instant case cited the case of Fleming v. Lowell Sun Co., 36 F.Supp. 320, reversed 120 F.2d 213, a decision by the District Court of Massachusetts as holding that the fourth paragraph of Section 9 of the Act, dealing with mandamus, must refer to something besides requiring the testimony of witnesses or the production of documentary evidence. The excerpt

from the decision of the court in that case, hereinafter set forth, discloses that it expressly refrained from deciding whether the fourth paragraph of Section 9 was or was not limited to compelling compliance with the matters referred to in the first three paragraphs of that section. In the Fleming case, the wage and hour administrator of the Labor Department applied to the District Court for an order directing the respondent to show cause why it should not be required to appear before the Administrator and produce books, records, etc., and give evidence required by a subpena duces tecum served upon the respondent. The respondent moved to vacate the order to show cause and this was denied by the court. Section 9 of the Fair Labor Standards Act, 29 U.S.C. §209, provided that for the purpose of any hearing or investigation provided for under that chapter, the provisions of Section 49 and 50 of Title 15 United States Code, relating to the attendance of witnesses and the production of books, papers and documents under the Federal Trade Commission Act, were made applicable to the jurisdiction powers and duties of the Administrator and the Secretary of Labor and the industry committees. The court said, at Page 325:

> "The respondent further argues that the fourth paragraph of Section 9 of the Federal Trade Commission Act limits the authority of the Administrator to bring these proceedings. This paragraph reads as follows: 'Upon the application of the Attorney General of the United States, at the request of the commission, the district courts of the United States shall

have jurisdiction to issue writs of mandamus commanding any person or corporation to comply with the provisions of this Act [subdivision of this chapter] or any order of the commission made in pursuance thereof.'

"Clearly, in view of the fact that the preceding paragraphs of this section expressly authorize the proceeding with which we are concerned, this paragraph must refer to something besides requiring the testimony of witnesses and production of documentary evidence. It can be construed as an added and alternative method of compelling obedience to a subpoena of the Administrator or it may have reference solely to 'orders of the commission'. Cf. Chamber of Commerce of Minneapolis et al. v. Federal Trade Commission et al., 8 Cir., 280 F. 45, 48, where it was held that the orders referred to in this clause were those involved in paragraph (b) of Section 6 of the Federal Trade Commission Act, 15 U.S.C.A. § 46(b). It is not necessary to determine whether it makes provision for an alternative method or that it refers merely to orders described under Section 6 (b) because of the fact that it is plain that it in no way abolishes the authority to proceed as outlined in the preceding three paragraphs of Section 9."

Here the court was considering a single isolated section of the Act and was not considering the history or provisions of the Federal Trade Commission Act making final Cease and Desist Orders of the Commission subject solely and only to enforcement by the Circuit Courts of Appeal, or to the fact that Section 45(L) of that Act provided that the sole remedy for violation of a final Cease and Desist Order was a pecuniary penalty.

The underscored portion from the Opinion of the Court clearly demonstrates that the court did not even decide that the District Courts had power to issue writs of mandamus or injunctions to enforce compliance with final Cease and Desist Orders.

From the foregoing, it follows that Section 9 of the Federal Trade Commission Act (15 U.S.C. § 49), authorizing the District Courts on application of the Attorney General to issue writs of mandamus, provides a legal and not an equitable remedy which may be used in a limited type of cases only. Such section is not applicable to final Cease and Desist Orders, in which cases the law provides that exclusive jurisdiction to enforce the orders of the Commission is in the Courts of Appeal and that the jurisdiction of the District Courts is limited to the imposition of civil pecuniary penalties for violations of such orders. The cases cited and relied upon by the District Judge are inapplicable because in each of those cases, the statutes involved specifically granted the equitable remedy of injunction power to the District Courts. Here it is granted to the Courts of Appeal.

When Congress enacted the Wheeler-Lea Amendment in 1938 providing the new single step procedure for enforcing

final Cease and Desist Orders, it provided for a pecuniary penalty for violation thereof. This penalty was recoverable in a "civil action". The present case is such a civil action. It is clearly not an "application of the Attorney General of the United States, at the request of the Commission" for the issuance of a writ of mandamus "commanding any person or corporation to comply with the provisions" of the Act or of any order of the Commission made pursuant thereto.

The Wheeler-Lea Amendment and the Federal Rules of Civil Procedure, including Rule 81(b), which revoked the power of the District Courts to issue writs of mandamus, were adopted in 1938. From this it would seem to follow that if Section 9 of the Act ever had any application to final Cease and Desist Orders, Congress, by substituting the civil pecuniary penalty for violations of such orders as a substitute for enforcement thereof by writs of mandamus, revoked the jurisdiction of the District Courts to issue such writs.

If District Courts had jurisdiction to issue injunctions enforcing final Cease and Desist Orders, are such orders merged into and superseded by the judgment under the doctrine of merger? Under that doctrine, a claim or cause of action is merged into and superseded by a final judgment involving the same cause of action and issues. A new liability on the judgment is created.

U.S. v. Leffler, 11 Pet. 86, 9 L.Ed. 642;

Gaines v. Miller, 111 U.S. 395, 28 L.Ed. 466;

Commissioner of Internal Revenue v. Sunnen,

333 U.S. 591, 92 L.Ed. 898;

If the Cease and Desist Orders are merged into and superseded by the judgment, and the judgment should be violated, what is the remedy? Is the sole remedy a contempt proceeding? Can there be a civil penalty action for violation of the Cease and Desist Order, when such order has been superseded by and merged into the judgment? Certainly, the court cannot superimpose the contempt remedy on the civil pecuniary penalty remedy that Congress has provided.

These questions pose problems which are dissipated by following the clear provisions of the Act, by holding that the sole remedy for violation of final Cease and Desist Orders is the recovery of the pecuniary penalty.

D. The court was without subject matter jurisdiction in the absence of pleading and proof of compliance with Section 16 of the F.T.C. Act requiring certification of the facts by the Commission to the Attorney General as a prerequisite to suit.

Section 16 of the Federal Trade Commission Act, 52 Stat. 114; 15 U.S.C. § 56, provides that "whenever the Federal Trade Commission has reason to believe that any person, partnership, or corporation is liable to a penalty under Section 14 or under sub-section L of Section 5, it shall certify the facts to the Attorney General, whose duty it shall be to cause appropriate proceedings to be brought for the enforcement of the provisions of such section or sub-section."

In U. S. v. St. Regis Paper Co., (2 Cir. 1966), 355 F.2d 38, the Court of Appeals held that certification of the facts disclosing that a respondent in a final Cease and Desist Order case is liable to a penalty under sub-section L of Section 5 of the Act, was mandatory and jurisdictional, and that in the absence of proof thereof, the District Court was without subject matter jurisdiction.

In the instant case, the complaint did not allege, no evidence was introduced to show, and there was no finding by the Court of the required certification of the facts by the Commission to the Attorney General (Comp., C.T. 2-10, Findings on Summary Judgment, C.T. 88-91, Findings after Trial, C.T. 95-98). Lack of subject matter jurisdiction was raised by the defendants in their motion for a new trial (C.T. 101). Under the holding of the St. Regis case, the court below lacked subject matter jurisdiction, particularly over Counts Three, Four, Five and Six, which were added after the original action had been instituted.

E. The finding that the advertisements involved in Counts Three, Four, Five and Six were disseminated in interstate commerce was not supported by any evidence and such dissemination was not the proper subject of judicial notice.

Counts Three, Four, Five and Six (C.T. 5-9) alleged that the advertisements there pleaded (Exhibits D, E, F and G, C.T. 24-27) were caused to be disseminated in interstate

ommerce by the defendants in the "Washington Post" and Virginian Pilot" (Count Three, C.T. 6); in the "Evening Star" ublished in Washington, D. C., the "Virginian Pilot" published n Norfolk, Virginia, the "Richmond Times Dispatch" published n Richmond, Virginia, and the "Beacon Journal" published in kron, Ohio (Count Four, T.D. 6-7); the "Washington Post", Richmond Times Dispatch", "Virginian Pilot" and "Beacon Jour- al" (Count Five, C.T. 7); the "Evening Star", "Washington ost", "Virginian Pilot" and "Richmond Times Dispatch" (Count ix, C.T. 8-9).

No evidence to support these allegations was produced by he Government on its cross-motion for summary judgment which as granted by the Court (C.T. 7-8).

No finding was made by the Court in granting summary udgment to plaintiff on these four counts, either that Herbold omade was offered for sale in interstate commerce or what ssues of what newspapers were disseminated in interstate com- erce in connection therewith (C.T. 88-91).

After trial of Counts Three, Four, Five and Six as to he defendant Milton Herbold individually, at which no evidence as introduced to prove the above mentioned allegations, or that r. Herbold, individually, was responsible for the publication f said advertisements, and following oral argument at which the ntire lack of such evidence was called to the attention of the ourt, the Court supplied the lack of evidence by its Finding f Fact 7, which was based on the "court taking judicial notice hat the 'Washington Post' and 'Evening Star' are circulated in nterstate commerce." No finding was made that the advertise-

ents published in the "Virginian Pilot", or the "Richmond Times ispatch", or the "Beacon Journal" were or were not disseminated n interstate commerce.

The Federal Trade Commission Act derives from and is ased upon the Commerce Clause of the Constitution, Article 1, ection 8, Clause 3. This is the source of the power of the ommission to issue Cease and Desist Orders.

One of the essential elements to the jurisdiction of the ommission to issue Cease and Desist Orders is proof that the espondents in such a proceeding disseminated or caused to be isseminated in interstate commerce, an advertisement which vio- ated the provisions of the Act. (C.T. 3-4).

Since the Order itself is directed against the dissemin- tion of advertisements in interstate commerce, the burden was pon the Government in an action to recover penalties under sub- ection L of Section 5 of the Act, to prove that the advertise- ents relied upon were disseminated in interstate commerce.

Since this was an action to recover penalties for viola- ion of an order, the complaint should be strictly construed gainst the Government. (Connolly et al v. U.S. (9 Cir. 1925), 49 F.2d 666).

In the Connolly case, an action was brought by the nited States, seeking an injunction, damages and other relief ecause of the defendants' alleged acts in herding cattle and orses on an Indian reservation without a grazing permit. The ourt, after trial, granted the injunction, nominal damages, and mposed a penalty under the statute. The complaint prayed for n injunction, for damages in a specified amount, and for gen-

The Connolly case is just the reverse of the present case. In the present case, the only relief sought was the statutory pecuniary penalties. No reference was made to an injunction, yet the court granted one in addition to imposing the penalties. In this connection, the Court of Appeals in the Connolly case said, "The lower court's opinion admits that no reference was made to the statutory penalty in the complaint. According to the trial court's opinion and as plainly shown by the record, the matter of the statutory penalty was never litigated. It might have been raised in final argument but that was after the evidence was in - - -. Although the distinctions between law actions and suits in equity are abolished, we must still keep in mind, in a case like the instant one, that statutes imposing penalties are strictly construed and pleadings to recover statutory penalties are likewise strictly construed. Furthermore, where the statute, as here, provides a remedy for the collection of a penalty, that remedy must be followed." This court reversed the District Court's judgment awarding a penalty. The above language of the Court of Appeals is in point in the instant case.

It has generally been held that in actions for penalties for violations of orders, all questions of doubt must be resolved in favor of the defendants and that the burden is upon the Government to prove its case by evidence beyond a reasonable doubt.

Chaffee & Co. v. U.S., 85 U.S. 516, 21 L.Ed. 908 (an action for penalties for alleged frauds upon the Revenue.);

Bowles v. Farmers National Bank, 147 F.2d 425;

Hatfried, Inc. v. C.I.R., 162 F.2d 628;

Ward Ins. Co. v. Pipes, 255 F.2d 464;

U.S. v. St. Regis Paper Co., 181 F.Supp. 862;

One 1958 Plymouth Sedan v. Pennsylvania,

380 U.S. 693, 14 L.Ed.2d 170.

Certainly a court should not be permitted to instruct a jury in a penalty case requiring proof to the degree above mentioned, that one of the essential elements must be found as a fact against the defendant because the court or the jurors must judicially notice it even though they have no knowledge of it.

In the instant case, we wonder why the plaintiff did not, either in support of its Motion for Summary Judgment or at the trial, produce evidence that the specific issues of the newspapers in which the advertisements were admittedly published were disseminated in interstate commerce if they, in fact, were. Certainly the astute prosecutors knew that they had the burden of proving this essential element.

It is not enough for the court to judicially notice that the "Washington Post and Evening Star are circulated in interstate commerce." The proof must be that the specific issues of the paper containing the questioned advertisements were disseminated in interstate commerce. The court did not take judicial notice that those specific issues were disseminated in interstate commerce and we do not see how the court could do so.

Proof was essential that the following issues of the newspapers were disseminated in interstate commerce:

The "Washington Post" for Monday, March 8, 1965 (Count Three);

Four);

The "Washington Post" for Monday, April 5, and Tuesday, May 4, 1965 (Count Five);

The "Evening Star" for Tuesday, September 21, 1965, Monday, October 4, 18, November 8, 1965, or the "Washington Post" for Monday, September 27, 1965, or Tuesday, October 12, 1965, or Tuesday, October 26, 1965, or Monday, November 15, 1965 (Count Six).

While a judge may take judicial notice of facts that are so well and universally known that they could not be disputed, the mere fact that the judge knows, or thinks he knows something, does not justify him in taking notice of it, if it is not a proper subject of such notice.

Witkin, California Evidence, 2d Edition, P. 146, § 151.

Where judicial notice is mandatory, the effect is substantially that of a conclusive presumption; i.e., the indisputable fact must be accepted and no evidence can be offered to dispute it. (Ibid).

Under California Evidence Code § 451(f), judicial notice must be taken of facts and propositions of generalized knowledge that are so universally known that they cannot reasonably be the subject of dispute. However, under § 452(g), it is optional to take judicial notice of facts and propositions that are of such common knowledge within the territorial jurisdiction of the court that they cannot reasonably be the subject of dispute. The reference to the territorial jurisdiction of the court refers to the county in which a Superior Court is located or the judicial

district in which a Municipal or Justice Court is located. In the case of the United States District Court, it would presumably be the territorial jurisdiction of the Central District of California.

In the case of Varcoe v. Lee, 180 Cal. 338, the court considered the tests to be applied in determining whether judicial notice should or should not be taken and in this connection said, at Page 346:

> "The tests, therefore, in any particular case where it is sought to avoid or excuse the production of evidence because the fact to be proven is one of general knowledge and notoriety are (1) is the fact one of common, everyday knowledge in that jurisdiction, which everyone of average intelligence and knowledge of things about him can be presumed to know; and (2) is it certain and indisputable. If it is, it is a proper case of dispensing with evidence, for its production cannot add or aid. On the other hand, we may well repeat, if there is any reasonable question whatever as to either point, proof should be required."

In the trial court, the plaintiff cited and relied upon the case of Delbridge v. U.S. (C.A.D.C. 1958), 262 F.2d 710, where the Court of Appeals for the District of Columbia took judicial notice of the fact "that the Sunday editions of the Washington newspapers are sold as far away as Raleigh, North Carolina." The facts in that case were that the defendant was

convicted of entering a store in which he had been employed and stealing $1125.66. Three years later, he told a Sheriff in California that he believed that he was wanted in the District of Columbia for the theft of $1175.00 from the named store. At his trial, he testified that on the night of the burglary, he passed the store, saw the door open, went in to investigate, saw the place in a disarray, and because he had a criminal record and was on parole, he left town and the next day he bought a paper in Raleigh, North Carolina, in which he saw a short article to the effect that the door to the store was open, that somebody had entered it, apparently with a key, and that the total sum of $1175.00 was missing. Hence, the discrepancy between the two sums above mentioned was a crucial point in the case. After conviction, defendant moved for a new trial and produced from the Library of Congress an article in the "Washington Post" on the Sunday following the burglary, stating that $1175.00 had been stolen from the store, giving its name, and that the store was evidently entered by the use of a key. The Court of Appeals held that a new trial should have been granted to permit the jury to pass upon this new evidence. Here then, we had a situation involving the Court of Appeals in the same territory where the trial was held taking judicial notice that the Sunday edition of the Washington newspapers were circulated as far south as Raleigh, North Carolina. The distinction between that case and the present case is clear. In that case, the judicial notice was taken by the court sitting within the District of Columbia, where the trial was held, and the fact judicially noticed related to the Sunday edition of the newspa-

pers published in that district. In the present case, a judge in California has taken judicial notice that newspapers published several thousand miles away in the District of Columbia were disseminated in interstate commerce. None of the issues of the newspapers involved in the instant case was a Sunday edition of a Washington newspaper. Proof of the circulation of the Washington newspaper as far south as North Carolina was not an essential element of the offense for which the defendant was on trial in the Delbridge case. In the instant case, proof of circulation of the newspaper in interstate commerce is an essential element which the plaintiff must prove beyond a reasonable doubt in order to recover the statutory penalties.

F. The court erred in holding that the advertisements pleaded in Counts Three to Six stated or represented that Herbold Pomade would "impart the former natural shade or color to gray, streaked or faded hair".

The court set forth parts of the advertisements involved in these counts, which are Exhibits D, E, F and G to plaintiff's Second Amended Complaint and emphasized that the underscored portions thereof particularly made the representation prohibited by the Cease and Desist Order (C.T. 89:5 - 90:25).

Since these findings are based solely on the written advertisements themselves and not upon oral evidence, this court is not bound by the determination made by the District Court, but may read the advertisements and determine for itself

whether they do or do not represent that the Pomade will impart the former natural shade or color to gray, streaked or faded hair. The "clearly erroneous" provision of Rule 52(a) F.R.Civ.P. has no application.

U. S. v. El-O-Pathic Pharmacy, (9 Cir), 192 F.2d 62;
Brinker-Johnson Co. v. Barnes (9 Cir), 272 F.2d 25;
U. S. v. John McShain, Inc., 258 F.2d 422;
Kwikset Locks, Inc. v. Hillgren (9 Cir), 210 F.2d 483.

In reading the advertisements, the court should, of course, read the whole advertisement and determine whether they did or did not make such a representation.

The Cease and Desist Order which defendants were charged in Counts Three to Six with violating provided that, in connection with offering Herbold Pomade for sale in interstate commerce, the respondents should cease and desist from disseminating in interstate commerce any advertisement which represented that Herbold Pomade "will impart the former natural shade or color to gray, streaked or faded hair" (C.T. 12:22 - 13:14).

The Order does not define the meaning of "the former natural shade or color". In its ordinary meaning, the word "former" means prior, earlier, or previous in point of time. As used in the Order, it presumably means at some time previous to the time that the hair of the user started to fade or become gray. It does not appear, however, whether this time was immediately prior to the time that the color of the hair started to fade or become gray or to what prior period of time in the user's life reference is made.

Nor does it appear what is meant by the term "natural shade or color".

It is a well known fact that the color shade of a human's hair changes from what it was when that person was born (assuming he was born with hair). Dark hair generally tends to become lighter in color, blonde hair generally tends to become a mousy color and red hair generally tends to become sandy in color.

According to the dictionary, the word "natural" is "a state provided by nature without man made changes". Synonyms are "not acquired, true, original". "Shade" is the "degree of darkness of a color" or the "gradation of a color with reference to its mixture with black". "Color" is defined as "that quality of visual sensation distinct from form, the evaluation by the visual sense of that quality of light reflected or transmitted by a substance which is basically determined by its spectoral composition . . . that which is used for coloring, pigment, paint, dye."

See Webster's New International Dictionary, 2d Edition.

On the other hand, the word "natural" shade or color as used in the Cease and Desist Order may be intended to be the antonym or opposite of artificial. This could be the intent of this rather ambiguous Order, since the Findings of Fact made by the Commission states that the shade or color "produced is not natural or natural like, but, on the contrary, is artificial and unnatural." (C.T. 20:30-32). If such be the meaning of this ambiguous Order, it should be noted that the Court did not make any finding that the advertisements represented that the shade

or color resulting from the use of the Pomade was artificial or unnatural. Instead, the Court found that the advertisements represented that the Pomade would in effect restore or replace the original natural shade or color that had been lost by the hair becoming gray (C.T. 89:5 - 90:20).

The advertisements pleaded in Counts Three to Six are Exhibits D, E, F and G to the Second Amended Complaint (C.T. 24-27). Each of these advertisements in the heading or the sub-heading states, 'Just a dab a day keeps the gray away" and that 'Amazing hair cream tones down grayness. Hair looks young again.' Neither Exhibit D, E nor G represent that following the use of the Pomade the color of the hair will be natural as distinguished from artificial. Hence, if the Cease and Desist Order uses the term "natural' as the opposite of "artificial" or "unnatural", neither of these advertisements violates the Cease and Desist Order (Counts Three, Four and Six, C.T. 24, 25, 27). Exhibit F involved in Count Five (C.T. 26) does state that the improvement is real and subtle "without a dyed artificial look" and upon this interpretation of the Order, such language or that advertisement would violate the Order, although this was not the basis of the finding of the trial court.

The advertisements, when read as a whole, do not state or represent that Herbold Pomade will impart the "former natural shade or color' to gray, streaked or faded hair. They do represent that the user's gray, streaked or faded hair becomes <u>young looking</u> again, but not that the young looking hair is the same shade or color with which it was endowed by nature. They also state or imply that the <u>user</u> will look younger, because the

gray, streaked or faded hair made the user look older than he was. The darkening of the hair will make him look younger. This was the underlying theme of each of the advertisements in question and the language of those advertisements is more restrained than the theme in advertisements for competitive products, which were submitted in support of the defendants' Motions for Summary Judgment.

Each of these advertisements (C.T. 24-27) states, "Not a coal tar dye, but a special rich hair cream that keeps the gray away by replacing lost color and oils so vital to young healthy-looking, well groomed hair."

Exhibits D and F both state, "as grayness gradually disappears your hair becomes young looking again," and Exhibits E and G state "as grayness gradually disappears, your hair becomes lustrous and young looking again."

Exhibit G states, "If the years have stolen the natural color and oils from your hair, leaving it gray, streaked, dry, lifeless, faded or yellowish; making you look older than you really are; simply use Herbold Pomade as your hair dressing. It will blend in lasting color just right for your hair, but will not change its shade; only brighten it."

Exhibit E is substantially the same except that it omits the words "making you look older than you really are."

Exhibit D states, "Regular use of Herbold Pomade will keep your hair young looking for as long as you use it."

Exhibit G states, "Tones down grayness. Hair looks young again without changing your natural shade." The same statement appears in substance in Exhibits D, E and F, except

except that the words "without changing your natural shade" are omitted.

In the Findings of Fact on plaintiff's Cross-Motion for Summary Judgment, the Court quoted parts of the advertisements in question and was of the view that the following statements in the advertisements, particularly the underscored portions, represented that the Pomade would impart the former natural shade or color to the hair: "Not a coal tar dye, but a special rich hair cream that keeps the gray away by replacing lost color and oils so vital to young healthy-looking, well groomed hair." (C.T. 89-90).

It is noted that the quoted portions of the advertisements are but a small part of one paragraph thereof and that a reading of the advertisements as a whole discloses that none of them represents that the Pomade will "impart the former natural shade or color" to the hair.

As shown by the exhibits submitted in support of defendants' Motions for Summary Judgment (C.T. 60-75), competitors are permitted by the Commission to advertise their hair coloring products by using language which the Order prohibits defendants from using. Thus, Exhibit 1, (C.T. 62), an advertisement of Grecian Formula 16, states that it will gradually build "up the natural looking color" and that after using it for two or three weeks "you can see hair color so natural you hardly remember how you looked when you were gray" and that the user will look younger, and that by the use of the product "you can change gray hair to natural looking color".

Exhibit 2 (C.T. 63), an advertisement of Kolor-Bak Pomade, states "gradually feeds a young and natural-looking color to gray hair" and that it adds a "natural looking color" to gray hair.

Exhibit 3 (C.T. 64), advertisements for Top Secret, a hair coloring product in "Esquire Magazine" and other publications, state that the product "imparts natural looking color to gray or faded hair" and the advertisement for 21 Plus "gray hair vanishes - natural looking color returns". The advertisement for Look-Younger Hair Cream states that it brings "natural looking color" to your hair gradually.

Exhibits 4 and 5 (C.T. 65-66), an advertisement of Bon Coif Hair Color Restorer by I. Magnin & Co., states that it is a "hair color restorer" and that it returns grey hair "to natural-like color instantly."

Exhibit 6 (C.T. 67), an advertisement for Loving Care by Clairol in "Readers Digest", states that it "seeks out grey and colors it young again without changing your natural hair color."

Exhibit 7 (C.T. 68), an advertisement in "Reader's Digest" of Clairol 4-Week Rinse, states that it rinses the gray away "to make your best years last longer", that it "matches your natural hair color - won't change it" and "makes hair color look young, feel young, shine like a girl's again - natural looking".

Exhibit 9 (C.T. 70), an advertisement for Great Day in the 'Reader's Digest" also emphasizes that the product will make the user look much younger and states that by using it

"a man can return his graying hair to a soft, rich natural-looking color in the privacy of his own bathroom" but that "it does not change your natural hair color. It only works on the gray" and that it can say "hair color so natural only his barber knows for sure".

The remaining exhibits are all on the same theme. These advertisements were not submitted to prove that the manufacturers of the products advertised were violating the Cease and Desist Order against the defendants in the instant case, for the obvious reason that such manufacturers were not parties to such Cease and Desist Order. They were submitted primarily to show that the Commission apparently by inaction, tacitly approves advertisements for hair coloring products which state that the product will make the hair look younger or the user look younger, by changing the gray hair to a darker color or another color. If these competitors are permitted to advertise their product in the language referred to in these advertisements, and the appellants herein are prohibited from so doing, there would certainly appear to be unwarranted discrimination.

It is not asserted by the Government in this case that Herbold Pomade is not a hair coloring product or that it will not change the color of gray hair by darkening it, nor do appellants contend that the competitive products will not color gray, streaked or faded hair.

We submit that a fair reading of the advertisements does not disclose that the appellants violated the Cease and Desist Order by causing the publication of the four advertisements which are the subject of Counts Three to Six inclusive. The

affidavit of Milton Herbold (C.T. 49-76) in support of defendants' Motions for Summary Judgment and the exhibits attached thereto summarize the questioned advertisements as well as the advertisements for the competitive products, and points out at C.T. 58-59, that hair becomes gray because it has little or no melanin, that no way has been found to activate hair which has little or no melanin into producing melanin again, but that by producing pigment on the hair that is similar in appearance to melanin, it will deposit such pigment on the hair shaft, thereby changing the color of the gray hair.

VII. CONCLUSION

For each and all of the foregoing reasons, it is respectfully submitted that the Court was without statutory power to grant injunctive relief, particularly in the absence of pleading, evidence and findings showing that the plaintiff was entitled thereto, that the Court was without subject matter jurisdiction, that the findings that the questioned advertisements were disseminated in interstate commerce are unsupported by evidence, and that the questioned advertisements in Counts Three to Six do not violate the Cease and Desist Order.

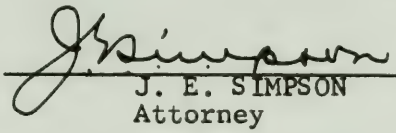
The Judgment should be reversed.

Respectfully submitted,

J. E. SIMPSON
Attorney for Appellants

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules and that I was responsible for the preparation of the brief.



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NO. 22105

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FOR THE NINTH CIRCUIT

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MILTON HERBOLD,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

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APPEAL FROM
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FOR THE CENTRAL DISTRICT OF CALIFORNIA

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APPELLEE'S BRIEF

JURISDICTION

Appellant seeks by this appeal to review a final judgment entered in favor of the appellee, United States of America. The court below had jurisdiction under 28 U.S.C. §1345. The judgment, entered March 10, 1967, being a final decision, this Court has jurisdiction under 28 U.S.C. §1291.

STATEMENT OF THE CASE

The appellee is in substantial agreement with the appellants' statement of facts. However, the appellee does not agree with the statement found on page 8 of the Appellants' Opening Brief that the pleadings did not allege any facts showing any basis for injunctive

relief. The Second Amended Complaint, page 2, Transcript of Record, alleges a large number of violations of the Cease and Desist Order in six counts. The facts contained in these allegations support the injunction granted by the trial court.

In addition, the appellee would point out that the appellants admitted the publication of the advertisements referred to in Counts Three through Six of the Second Amended Complaint [T. R. 30-32; 34-35]. 1/ Finally, the appellee disputes the contention found on page 8 of the Appellants' Opening Brief that there is no finding of fact to support a judgment granting injunctive relief. The appellee contends that a sufficient finding was contained in the Findings of Fact and Conclusions of Law filed March 9, 1967 [T. R. 95], and in the Memorandum Decision on Motion for New Trial filed May 1, 1967 [T. R. 201].

ISSUES PRESENTED

The issues presented on this appeal are:

1. Were the advertisements,which were the subject matter of Counts Three, Four, Five and Six of the Second Amended Complaint, disseminated in interstate commerce?

2. Was the Finding of Fact made on January 26, 1967 [T. R. 90], that the statements made in the advertisements in Counts Three, Four and Five represent that Herbold Pomade will impart the former natural shade or color to gray streaked or

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1/ Transcript of Record.

faded hair clearly erroneous?

3. Did the District Court have subject matter jurisdiction over the penalty action?

4. If the District Court had the power to issue an injunction, did it abuse its discretion in granting the injunction?

5. Did the District Court have power to issue an injunction?

SUMMARY OF ARGUMENT

Section 4 of the Federal Trade Commission Act defines commerce as follows:

> " 'Commerce' means commerce . . . in the District of Columbia, ... "

The Second Amended Complaint [T.R. 2] alleged in paragraph 4 the Cease and Desist Order which is the subject matter of this litigation. By terms of the Cease and Desist Order the defendants were ordered to cease and desist from disseminating or causing to be disseminated by means of the United States Mails or by means in commerce as "commerce" is defined in the Federal Trade Commission Act. In their Answers to the Second Amended Complaint, the defendants admitted the publication of the advertisements involved in Counts Three, Four and Five in the Washington Post and the Washington Star. This publication was a violation of the Cease and Desist Order under the definition of "commerce"

meaning commerce in the District of Columbia. The trial court was correct in taking judicial notice that the Washington Post, the Evening Star and the National Enquirer are circulated in interstate commerce.

The trial court found as a matter of fact that the advertisements involved in Counts Three, Four, Five and Six of the Second Amended Complaint violated the Cease and Desist Order. This finding should not be disturbed unless clearly erroneous. The findings that the advertisements violated the Cease and Desist Order was not only not clearly erroneous, it was the correct decision.

The District Court had subject matter jurisdiction of the penalty action because the facts of this case were certified to the Attorney General by the Federal Trade Commission and required by law.

The trial court's finding that the government was entitled to an injunction based on the facts alleged and proved at trial should not be disturbed unless it is clearly erroneous. There is no merit to the appellants' argument that the trial court should not have imposed the injunction because it was specifically asked for for the first time at trial.

The District Court had equitable jurisdiction and the power to issue an injunction. The case of United States v. Parkinson, 240 F. 2d 918 (9th Cir. 1956), is an inaccurate statement of the law and, insofar as it bears on this case, should be overruled.

ARGUMENT

I

THE ADVERTISEMENTS WHICH WERE THE SUBJECT MATTER OF COUNTS THREE, FOUR, FIVE AND SIX OF THE SECOND AMENDED COMPLAINT WERE DISSEMINATED IN INTERSTATE COMMERCE.

At page 12 of their Opening Brief, the appellants listed as an issue presented possible error by the trial court in finding that the advertisements were disseminated in interstate commerce. The appellants argued this question starting at page 46 of their Opening Brief. This issue and suggestion of error is completely unfounded. The express terms of the cease and desist order which gave rise to the allegations in Counts Three, Four, Five and Six of the Second Amended Complaint were that the appellants were not to disseminate certain advertising in commerce, as commerce is defined by the Federal Trade Commission Act. Section 4 of the Act defines commerce as follows:

> " 'Commerce' means commerce . . . in the District of Columbia. "

The appellants admitted the publication of the advertising which the plaintiff alleged violated the cease and desist order in the Washington Post and the Washington Morning and Evening Stars. The dissemination in commerce having been admitted by the appellants, proof on this question was unnecessary and there was no issue at trial about dissemination insofar as the Washington, D. C. papers were concerned.

The dissemination in commerce was also established by the trial court's having taken judicial notice of the fact that the National Inquirer, the Washington Post and the Washington Evening Star are disseminated in interstate commerce. It is the appellee's position, first that this taking of judicial notice was entirely proper by the trial court and, second that the appellants are in no position to present any issues about interstate dissemination. The court's taking judicial notice of the fact that the National Inquirer, the Washington Post and the Washington Star are newspapers which are circulated in interstate commerce was a correct application of the doctrine of judicial notice. In the California case of In Re Lawrence, 55 Cal. App. 2d 491, 497 (1942), the court used the following language:

> "Knowledge that is generally possessed is the subject of judicial cognizance, and the courts will not shut their eyes and ears to the every-day happenings of contemporary life."
>
> In Re Lawrence, supra, at 497.

Broad application has been given to the doctrine of judicial notice in the Ninth Circuit. In the early case of Greeson v. Imperial Irr. Dist., 59 F. 2d 529, 531 (9th Cir. 1932), the court stated that, "Judicial knowledge is taken of all matters generally known."

More directly in point is the case of Delbridge v. United States, 262 F. 2d 710, 720 (D. C. Cir. 1958). The common sense of the court's ruling in this case is supported by the discussion of

judicial notice in the article Evidence of the New Federal Rules of Civil Procedure, by Charles C. Callahan and Edwin E. Ferguson, 47 Yale L. J. 194, 210, et seq., in which the authors suggest that the courts should take judicial notice of any matter of common knowledge or of any matter not capable of bona fide dispute. The Government submits that the appellants cannot in good faith dispute the fact that the National Inquirer, the Washington Post, and the Washington Star are circulated in interstate commerce.

The second reason for the appellee's argument that the appellants cannot now raise the question of dissemination in interstate commerce relates to the plaintiff's cross-motion for summary judgment filed on November 17, 1966 [T. R. 78]. In that motion the Government contended that there was no genuine issue of fact as to the defendant Herbold Laboratories, Inc. on Counts Three, Four, Five and Six of the Second Amended Complaint. Rule 3(g)2, Local Rules for the Central District of California, requires any person opposing a motion for summary judgment to serve and file a concise "statement of genuine issues" setting forth all material facts as to which it is contended there exists a genuine issue necessary to be litigated. No such statement of genuine issues was ever filed by the defendant Herbold Laboratories, Inc. At the hearing on the motion for summary judgment the court found that there were no genuine issues of fact remaining to be tried as against the defendant Herbold Laboratories, Inc. on Counts Three, Four, Five and Six of the plaintiff's Second Amended Complaint. In the objections to the findings of fact proposed by

the plaintiff on the plaintiff's cross-motion for summary judgment, filed December 13, 1966, the defendant Herbold Laboratories made this statement:

> "(c) Furthermore, issues of fact still remain as to whether the advertisements were or were not disseminated in interstate commerce contrary to the cease and desist order."

The Findings of Fact filed January 27, 1967 [T.R. 88], included a finding that the advertisements in Counts Three, Four, Five and Six were disseminated in interstate commerce. Because the defendant violated the local rule for the Central District by not filing a statement of genuine issues, and because the defendant cannot in good faith contend that the Washington Post and Washington Star and National Inquirer were not disseminated in interstate commerce, the action of the trial court in taking judicial notice of this fact should be upheld.

This is especially true in light of the defendants both having admitted dissemination in commerce within the meaning of the Federal Trade Commission Act.

II

THE FINDING THAT ADVERTISEMENTS ALLEGED IN COUNTS THREE, FOUR, FIVE AND SIX VIOLATED THE CEASE AND DESIST ORDER WAS NOT "CLEARLY ERRONEOUS".

Beginning at page 54 of their Opening Brief, the appellants argue that factually the advertisements involved in Counts Three, Four, Five and Six of the Second Amended Complaint do not violate the terms of the cease and desist order. In advancing this argument the appellants have presented the court authority which does not support their position on the question of the applicability of Rule 52(a), Federal Rules of Civil Procedure. The appellants cite the cases of United States v. El-O-Pathic Pharmacy, 192 F. 2d 62 (9th Cir. 1951); Brinker-Johnson Co. v. Barnes, 272 F. 2d 250 (9th Cir. 1959); and Kwikset Locks, Inc. v. Hillgren, 210 F. 2d 483 (9th Cir. 1954). The Kwikset Locks case deals with patents and is entirely inapplicable to the facts of this case. The El-O-Pathic Pharmacy case, beginning at page 67, recites as follows:

> "[N]evertheless a finding is 'clearly erroneous' when, although there is evidence to support it, the reviewing court, on the entire evidence, is left with the definite and firm conviction that a mistake has been committed; [citing cases]."

This language is hardly compatible with the appellants'

statement that the "clearly erroneous" provision of Rule 52(a), F. R. Civ. P. has no application to this case.

It is even less clear on what basis the appellants think the Brinker-Johnson case supports their proposition.

> "We have in mind that the finding of a trial court based upon documentary evidence does not carry the same degree of conclusiveness on us as does one made upon oral evidence, but from an examination of the indenture executed by the parties . . . we think the finding of the trial court is substantially supported."
>
> Brinker-Johnson Co. v. Barnes, supra, at 252.

Clearly the statement by the court in the Brinker-Johnson case is dicta and did not relate to the holding of the court. It is respectfully submitted that the dicta is not a correct statement of the law of the Ninth Circuit. The evidence relating to the alleged violation of the cease and desist order were the advertisements which the appellants admitted were published in the Washington, D. C., papers. On the basis of this primary evidence, the trial court drew inferences from which it found that there was a violation of the cease and desist order. It is the appellee's position that all of these findings were findings of fact inferred from documentary and uncontradicted testimony which, under the rule of the Ninth Circuit, are binding on the appellate court unless "clearly erroneous". The leading case in this circuit relating to that problem is Lundgren v. Freeman, 307 F. 2d 104 (9th Cir. 1962). The problem

to which the Lundgren court addressed itself is set in the following language:

> "There was some evidence that there was, in fact, no mutual mistake, but we are satisfied that the trial court's finding is supported by the evidence, viewed as a whole, and was not 'clearly erroneous'. We are bound by Rule 52(a), F.R.Civ.P., which provides that: 'findings of fact shall not be set aside unless clearly erroneous * * *' Therefore, we may not substitute our judgment if conflicting inferences may be drawn from the established facts by reasonable men, and the inferences drawn by the trial court are those which could have been drawn by reasonable men.
>
> "There seems to be considerable confusion as to whether Rule 52(a) allows an appellate court to disregard a trial court's findings where fact issues were decided on written evidence alone, so that the appellate court is as able to determine credibility as the trial court."
>
> Lundgren v. Freeman, supra, at 113.

After noting that there have been cases on both sides of the question in the Ninth Circuit, the Lundgren court went on to adopt the rationale now set forth in the case of Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278 (1960), where the Supreme Court talked about the "fact finding tribunal's experience with the

mainsprings of human conduct." The Ninth Circuit in the Lundgren case then expressed the view, at page 115, that many of the Ninth Circuit cases seemed to hold that the appellate court could review the facts de novo could be distinguished by the Commissioner of Internal Revenue v. Duberstein case, supra.

> "In all these cases the inferences drawn from the undisputed facts seem to have been inferences derived from application of a legal standard and not inferences derived from having had 'experience with the mainsprings of human conduct.'
>
> "In the principal case the finding of mutual mistake can be fairly said to be derived not solely from application of legal standards, but from the trial judge's experience with human affairs."
>
> Lundgren v. Freeman, supra, at 115.

This rule has been followed in other cases, and finds its most recent expression in the case of Stauffer Laboratories, Inc. v. F.T.C., 343 F.2d 75 (9th Cir. 1965).

> "Although the texts of these advertisements are before us, and in that sense the facts as to what the advertisements were are undisputed, yet we are not for that reason free to disagree with the Commission's finding to the effect that the advertisements did make these claims for the effectiveness of the device independent of the plan. In reviewing the findings of a district court, the established rule,

recognized by this court, is that in respect to inferences drawn from undisputed facts the findings may not be set aside unless found to be clearly erroneous. Lundgren v. Freeman, 9 Cir., 307 F.2d 104, 115. In that case this court adopted the rationale employed by the Supreme Court in Commissioner v. Duberstein, 363 U.S. 278, 289, 80 S.Ct. 1190, 1198, 4 L.Ed.2d 1218, where the Court said: 'Decision of the issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct. . . .'"

Stauffer Laboratories, Inc. v. F.T.C., supra, at 78.

The test therefore is whether or not the finding by the trial court that the advertisements which were admittedly published as alleged in Counts Three, Four, Five and Six of the Second Amended Complaint were clearly erroneous. We submit that the findings were not clearly erroneous, but that a review of all of the advertisements will show that the findings by the trial court were the correct findings.

III

THE DISTRICT COURT HAD SUBJECT MATTER JURISDICTION OVER THE PENALTY ACTION.

At pages 45 and 46 of the Appellants' Opening Brief they argue that the court below was without subject matter jurisdiction, particularly over Counts Three, Four, Five and Six. The arguments advanced by the appellants do not contain accurate statements of the facts. The Second Amended Complaint (T. R. 2) alleges that "the United States of America, by the United States Attorney for the Southern District of California, acting under the direction of the Attorney General of the United States, and upon request of the Federal Trade Commission, brings this action to recover civil penalties . . . ". While this allegation is not, perhaps, a formal certification allegation, it certainly fulfills every requirement of United States v. St. Regis Paper Company, 355 F. 2d 688 (2nd Cir. 1966), for an allegation of certification of the facts found by the Federal Trade Commission to the Attorney General. Certainly this is true where, as here, the appellants only offer the suggestion that the court might be without subject matter jurisdiction and do not, even here, suggest that the Federal Trade Commission did not certify the facts to the Attorney General.

The appellants argue at page 46 of their Opening Brief that no evidence was introduced to show that the required certification of facts by the Commission to the Attorney General had been made. This statement is not true. The appellants correctly state that the

possibility of lack of subject matter jurisdiction was raised by the appellants (for the first time) on their motion for a new trial. In opposition to the motion for a new trial, the appellee filed the affidavit of Joseph S. Saunders on April 12, 1967. This document was not designated as a part of the record to be transmitted to the Clerk of the Ninth Circuit, but is noted in the minute orders [T.R. 112].

On page 46 of their Opening Brief, the defendants also state that there was no finding by the court of the required certification of facts. This statement is also incorrect. In his Memorandum Decision on Motion for New Trial filed May 1, 1967 [T.R. 102], the Honorable Judge William P. Gray found on the first page that the United States Attorney, under the direction of the Attorney General, pursuant to the request of the Federal Trade Commission, brought this action. This finding by the trial court is completely consistent with the evidence before it, to wit: the affidavit of Joseph S. Saunders, and is not contested by any evidence to the contrary by the appellants, although they choose not to advise this Court of what actually happened in the court below on the question of subject matter jurisdiction under the St. Regis rule.

The only thing remaining to the appellants' argument of a lack of subject matter jurisdiction is the suggestion that the court below lacked it particularly over Counts Three, Four and Five, which were added after the original action had been instituted. The effect of the appellants' argument is that Rule 15(d), Federal

Rule of Civil Procedure has no applicability to actions brought under the Federal Trade Commission Act, and as new facts develop during the course of the preparation of a case which had been certified by the Federal Trade Commission for trial would have to be formally certified as a new and separate matter. We suggest to the court that even the majority in the St. Regis case would not have gone that far. It would be a highly technical requirement, and would be a severe departure from the spirit of the Federal Rules of Civil Procedure, to argue that once a lawsuit has been instituted the Federal Trade Commission is required to certify facts as they develop during the United States Attorney's discovery activities and trial preparations. It would make no sense to require the government under circumstances such as these to go back to the Federal Trade Commission with each new discovery and obtain a certification. The purposes behind the Federal Trade Commission Act do not require such a holding. Neither does the holding by the St. Regis majority which was concerned least a person be faced with possible prosecution for violation of a cease and desist order by the Attorney General while at the same time satisfying the Federal Trade Commission with his compliance. The facts of the St. Regis case arose when the United States Attorney developed information in a grand jury investigation which, because it was secret, could not be furnished to the Federal Trade Commission. The concern that the St. Regis majority had for the possibility of suits for violations of cease and desist orders which were not under the control of the Federal

Trade Commission, simply does not exist under the facts of this case.

IV

THE DISTRICT COURT HAD THE POWER TO ISSUE A WRIT OF INJUNCTION AND IT DID NOT ABUSE ITS DISCRETION IN ISSUING THE WRIT OF INJUNCTION.

The appellants argue that even if the trial court had power to issue an injunction, it was error to do so because the pleadings did not specifically ask for injunctive relief. In answer to this line of argument, the appellee would point out that the same considerations apply to these arguments as applied to the appellants' argument that the advertisements did not violate the cease and desist orders. The facts upon which the trial court concluded that an injunction should issue must be affirmed unless they are shown to be clearly erroneous.

In this action, the United States filed its original complaint alleging two violations of the cease and desist order. During the pendency of the lawsuit, a second amended complaint was filed alleging in four additional counts numerous violations of the cease and desist order by publication in five newspapers and interstate circulation after the original complaint was filed. At the trial, there was evidence to support these subsequent violations. On the basis of this showing of repeated violations of the cease and desist order, the trial court determined that an injunction was a

proper remedy. The court's Findings of Fact and Conclusions of Law [T. R. 88, 95] set out the violation alleged in Counts Three, Four, Five and Six are sufficiently specific findings to support the injunction.

The appellants have cited in their argument that the court should not have issued an injunction in the absence of pleadings to show that the appellee is entitled to the injunction is clearly without merit. All of the facts which were relied upon by the government in asking for the injunction during final arguments of the case were pleaded with a great deal of particularity in the second amended complaint. The trial proceeded as a trial on these issues and the government introduced nothing new in support of its request for an injunction. The appellants have consistently overlooked the well known proposition that a party will be given all of the relief to which he is entitled under a general prayer. The appellants have also overlooked with the same degree of consistency the fact that:

> Federal Rules of Civil Procedure, Rule 15(b):
>
> "(b) Amendments to Conform to the Evidence. When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend

does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice him in maintaining his action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence."

Since the injunction in this case was requested on the grounds that the defendants had repeatedly violated the cease and desist order, and the evidence to support the request for the injunction was in fact the evidence showing the violations alleged in the complaint, the request for the injunction fell squarely within the language of the prayer of the second amended complaint [T.R. 2] "that plaintiff be given such other and further relief as this court may deem just and proper.", and the coverage of Rule 15(b), Federal Rules of Civil Procedure.

It is clear that in granting the injunction the trial court was exercising its discretion.

"... When such a situation arises, it is the duty of the trial court to ascertain if there is reason to fear future violations. The court, in the discharge

of this function, is invested with a sound discretion in reaching its conclusion as to whether an injunction should or should not be issued, and its decision will not be disturbed on appeal unless it appears that there has been an abuse of discretion."

Walling v. Shenandoah-Dives Mining Co., 134 F. 2d 395, 398 (10th Cir. 1943).

There is nothing in the record which would support the contention by the appellants that the trial court abused its discretion.

V

THE DISTRICT COURT DID HAVE POWER TO ISSUE AN INJUNCTION.

Running throughout most of the pages of the Appellants' Opening Brief are arguments that the District Court had no power to issue an injunction in aid of its monetary judgment. The appellants' arguments seem to be threefold. They argue that the case of United States v. Parkinson, 135 F. Supp. 208 (S. D. Cal. 1955), aff'd 240 F. 2d 918 (9th Cir. 1956), holds that the court lacks jurisdiction to issue an injunction unless that power is specifically given to the court by statute. The second line of argument of the appellants is that in Federal Trade Commission cases the district court has no equitable jurisdiction, which is lodged in the Court of Appeals. The third line of argument that with the elimination of writs of mandamus by the promulgation of

Rule 81(d), Federal Rules of Civil Procedure, whatever equitable jurisdiction the District Court had was eliminated. We will discuss these three matters in that order and will then argue that the trial court had jurisdiction to issue the injunction whether or not it had equitable jurisdiction to issue writs of mandamus under 15 U.S.C. §49.

If the Court finds that the Parkinson case, supra, has any application to this one, it should be overruled. In affirming the opinion of the trial court, the Parkinson court said that:

> "The use of extraordinary remedies of equity in governmental litigation should never be permitted by the courts unless clearly authorized by the statute in expressed terms."
>
> United States v. Parkinson, supra, page 922.

This holding is clearly inconsistent with the holding in Mitchell v. DeMario Jewelry, 361 U.S. 288 (1960). There, the Secretary of Labor brought an action to enjoin an employer from violating Section 15(a)(3) of the Fair Labor Standards Act of 1938 (29 U.S.C. §215(a)(3)). The trial court granted the injunction, but, as a matter of discretion refused the plaintiff's prayer that the defendant be required to make reimbursement for loss of wages caused by the unlawful discharge or other discrimination. The Court of Appeals affirmed on the basis that the District Court lacked jurisdiction to order such reimbursement, because any such jurisdiction " . . . must be expressly conferred by an act of Congress or be necessarily implied from a congressional enactment." (260

F. 2d 929, 933). The question involved was virtually identical with that involved in the Parkinson case since in both cases the government sought money damages as an ancillary remedy to an injunction proceeding. The important language used by Mr. Justice Harlin is found at pages 291 and 292, and is as follows:

" . . . We upheld the implied power to order reimbursement, in language of the greatest relevance here:

> 'Thus the Administrator invoked the jurisdiction of the District Court to enjoin acts and practices made illegal by the Act and to enforce compliance with the Act. Such a jurisdiction is an equitable one. Unless otherwise provided by statute, all the inherent equitable powers of the District Court are available for the proper and complete exercise of that jurisdiction. And since the public interest is involved in a proceeding of this nature, those equitable powers assume an even broader and more flexible character than when only a private controversy is at stake. . . . [T]he court may go beyond the matters immediately underlying its equitable jurisdiction . . . and give whatever other relief may be necessary under the circumstances. . . .

'Moreover, the comprehensiveness of this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied. "The great principles of equity, securing complete justice, should not be yielded to light inferences, or doubtful construction." Brown v. Swann, 10 Pet. 497, 503. . . . ' 328 U.S., at 397-398.

"The applicability of this principle is not to be denied, either because the Court there considered a wartime statute, or because, having set forth the governing inquiry, it went on to find in the language of the statute affirmative confirmation of the power to order reimbursement. Id., at 399. When Congress entrusts to an equity court the enforcement of prohibitions contained in a regulatory enactment, it must be taken to have acted cognizant of the historic power of equity to provide complete relief in light of the statutory purposes. . . . "

Mitchell v. DeMario Jewelry, supra, pages 291 and 292.

The DeMario case has been cited and quoted in a number of recent cases throughout the country. It was recently cited in the case of Katcher v. Lande, 382 U.S. 323, 338 (1965) and a number of circuits have expressly followed it. See Goldberg v. Dama Manufacturing Corp., 302 F.2d 152 (5th Cir. 1962); State of Alabama v. United States, 304 F.2d 583, 591 (5th Cir. 1962), ("Thus the relief in matters of public, rather than private, interest may be quite different from that ordinarily granted."); and Reich v. Webb, 336 F.2d 153, 158 (9th Cir. 1964), ("Only a clear expression of legislative intent will limit an equity court's power in this regard.")

Neither the Supreme Court in the DeMario case, supra, nor any of the Circuit Courts have cited United States v. Parkinson, supra. As far as we know, it has not been followed, expressly overruled or even noticed since it was written. There can be no doubt, however, that the express language of the Supreme Court is determinative of the issue of the District Court power to grant an injunction and the exercise of its equity power.

The question then becomes whether the court has any equity power in a suit under 15 U.S.C. §45(L). The trial court in its memorandum decision filed May 1, 1967 (T.R. 102), carefully considered the arguments advanced by the appellants, which are the same arguments presented here. We agree with the trial court that "it seems . . . quite clear that subsections (c) and (d) provide for the participation of the Court of Appeals only for the purpose of reviewing an order of the Commission before it becomes final,

and that once such review is undertaken neither the Commission nor any other entity has any jurisdiction to interfere in the matter. These provisions have nothing to do with proceedings under § (L) which may be instituted only after a Cease and Desist Order 'has become final' and the time for review has passed."

The Honorable Judge Gray concluded that if he had any equity jurisdiction whatever with respect to this case, all the inherent powers of the equity court were available to him. We agree entirely with this statement and also with the learned trial judge's determination that he did have equity jurisdiction under the fourth paragraph of §49, Title 15, U.S.C.

The state of the law is that:

> ". . . the comprehensiveness of this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied. 'The great principles of equity, securing complete justice, should not be yielded to the like inferences, or doubtful construction.' Brown v. Swann, 10 Pet. 497, 503."
>
> Porter v. Warner Co., 328 U.S. 397-398 (1946).

In an attempt to avoid the effect of this language in the holding in the DeMario Jewelry case, supra, the appellants have

attempted to show that exclusive jurisdiction to grant injunctions has been vested with the Court of Appeals by the Federal Trade Commission Act. Nowhere in their brief do the appellants reach the critical issue which was considered by Judge Gray that the exclusiveness of the jurisdiction in the Court of Appeals only relates to that period of time in which the person ordered to cease and desist can take review of the Cease and Desist Order. In at least eight places in their brief, the appellants make such statements as "and it provided in section 5d that the jurisdiction of the Courts of Appeal to enforce those final Cease and Desist Orders of the Commission should be exclusive." (Appellants' Opening Brief, p. 21); "Since the Circuit Courts of Appeal were vested with exclusive jurisdiction to enforce final Cease and Desist Orders of the Commission . . . " (Appellants' Opening Brief, p. 38, lines 2, 3 and 4); and "Such section is not applicable to final Cease and Desist Orders, in which cases the law provides that exclusive jurisdiction to enforce the orders of the Commission is in the Court of Appeals . . . " (Appellants' Opening Brief, p. 43, lines 15-17).

Such statements are completely incorrect. The jurisdiction of the Court of Appeals to enforce orders of the Federal Trade Commission arises only when review is sought directly in the Court of Appeals under the provisions of 15 U.S.C. §45(c). Jurisdiction of the Court of Appeals to enforce or set aside orders of the Commission exists only so long as the Federal Trade Commission's order has not become final under provisions of 15 U.S.C.

§45(g); Crown Zellerbach v. Federal Trade Commission, 156 F. 2d 927 (9th Cir. 1946). (It is interesting to note that the appellants in their Opening Brief cited the Crown Zellerbach case at page 40 with the statement that it cited and followed the case of Chamber of Commerce v. Federal Trade Commission, 280 Fed. 45 [8th Cir. 1922]; but the inference that the Crown Zellerbach case supported the Chamber of Commerce holding that the District Court did not have jurisdiction to make certain orders was not the issue before the Ninth Circuit in Crown Zellerbach and the Chamber of Commerce case was not cited as authority for any such position.)

The appellants' whole case turns on the question of whether the Court of Appeals was vested with exclusive jurisdiction to enforce final Cease and Desist Orders of the Federal Trade Commission and on an argument that the Parkinson case, supra, is still the law. We believe we have successfully demonstrated that Parkinson has been overruled by the Supreme Court in the DeMario case, supra. We also believe that it is abundantly clear that the exclusive jurisdiction of the Circuit Court over Cease and Desist Orders lasts only so long as the Cease and Desist Order is reviewable and does not continue over a final Cease and Desist Order.

In addition to these arguments, the appellants have cited Rule 81(b) of the Federal Rules of Civil Procedure to support their argument that the District Court has no equitable jurisdiction in this case. There is no substance in the appellants' argument that the adoption of Rule 81(b) by the Supreme Court has abrogated the

District Court's power to issue equitable writs. In the first place, the language of Rule 81(b) itself makes it apparent that the relief which a litigant could formerly obtain by a Writ of Mandamus is still obtainable under the Federal Rules of Civil Procedure by appropriate action or by appropriate motion. In the second place, 28 U.S.C. §2072 specifically provides that the Federal Rules of Civil Procedure "shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution."

It is, therefore, clear that, even if Rule 81(b) purported to strip the District Courts of their power to issue extraordinary writs, it cannot deprive a District Court from any right or power it formerly possessed. It is the appellee's position that the arguments of the appellants relating to Rule 81(b) are entirely irrelevant to the issues of this appeal.

The District Court had the power to issue a Writ of Injunction in this case. That power is confirmed by the Supreme Court's decision in the DeMario case, supra. It is confirmed by the fact that equitable jurisdiction was conferred on the District Courts under the Federal Trade Commission Act, as noted by Judge Gray, in 15 U.S.C. §49. Equitable jurisdiction was conferred on the District Courts under 15 U.S.C. §§52, 53 and 57, among others. In the absence of a clear congressional intent to limit the District Court's equitable jurisdiction, that jurisdiction is complete. Mitchell v. DeMario Jewelry, Inc., supra. In

addition to this evidence that the District Court had jurisdiction to issue an injunction, 28 U.S.C. §1652 provides that:

> "(a) The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdiction and agreeable to the usages and principles of law."

We submit that this provision of Title 28, U.S.C. is in itself enough authority for the District Courts having issued the injunction in this case. For all of these reasons, it is respectfully submitted that the decision of the District Court should be affirmed in all respects.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Larry L. Dier

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No. 22105

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HERBOLD LABORATORY, INC. and
MILTON HERBOLD,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' REPLY BRIEF

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APPELLANTS' REPLY BRIEF

Appellants prefer to and will follow the order of argument of the Opening Brief rather than the reverse order contained in appellee's brief.

I. APPELLEE HAS WHOLLY FAILED TO SHOW THAT THE DISTRICT COURT HAD STATUTORY JURISDICTION OR GENERAL EQUITY POWER TO GRANT INJUNCTIVE RELIEF IN THIS PENALTY ACTION.

In our opening brief (pp. 17-45), we argued that the District Court (1) had no statutory power under the Act to enjoin possible future violations of the final Cease and Desist Order, because Congress had provided an adequate legal remedy; (2) but that if the court did have such jurisdiction, the granting of such relief was error in the absence of a complaint

alleging facts and evidence showing, and findings determining, that in all probability the acts enjoined would be committed by defendants in the future unless defendants were enjoined; that such acts would result in substantial injury to plaintiff, that failure to grant the injunction would result in irreparable injury to plaintiff, and that plaintiff did not have an adequate legal remedy (Br. 27-30). Since appellee does not seem to be clear as to the basis of appellants' contentions (Appellee's Br. p. 20), we will restate them.

The first contention is predicated on the undisputed rule that District Courts are of limited jurisdiction which must find their jurisdiction in specific statutory grants. Such jurisdiction is never presumed. Instead, it is presumed the court is without jurisdiction and the burden is on appellee to demonstrate that the court has such jurisdiction (Br. 26-27). Appellee has not questioned these well established rules.

The District Judge conceded that Section 5(L) (15 U.S.C. §45(L)) contains no provision for an injunction (C.T. 104:18-21) and appellee has not contended otherwise.

It follows that the court was without statutory jurisdiction under Section 5 to grant injunctive relief enforcing compliance with the final Cease and Desist Order. If such jurisdiction existed, it must be found elsewhere.

In searching for statutory jurisdiction in the F.T.C. Act, the court relied upon the fourth paragraph of Section 9 (15 U.S.C. §49) conferring jurisdiction on District Courts to issue writs of mandamus in certain cases, commanding persons to comply with certain provisions of the Act or orders of the

Commission.

The fallacy of this position is that mandamus is a legal and not an equitable remedy. When the legal remedy of mandamus is available, the injunctive remedy is not, because mandamus provides an adequate legal remedy at law (Br. 35:20-22). It follows that since the legal mandamus remedy does not confer equitable jurisdiction, that provision did not carry with it the inherent powers of an equity court.

In our opening brief, we cited specific provisions of the Act which conferred jurisdiction to grant injunctive relief in certain cases. Those provisions conferred such jurisdiction on the Courts of Appeal in certain cases and upon District Courts in others (Br. 20-22).

Appellee complains (Br. 24-26) that appellants failed to discuss the court's view that subsections (c) and (d) of Section 5, vesting exclusive jurisdiction in the Court of Appeals over Cease and Desist Orders, applied only to cases in which a petition for review was filed. There are several reasons we did not refer to this holding of the court. First, we referred to subsections (c) and (d) conferring exclusive jurisdiction on the Court of Appeals to emphasize that subsection (L), providing pecuniary penalties for violation of final Cease and Desist Orders, contains no comparable provision empowering District Courts to make orders enforcing final Cease and Desist Orders. Instead, subsection (L) provides that the sole remedy for such violations is a civil action to recover pecuniary penalties. Second, we do not read the Wheeler-Lea Act as disclosing an intent to provide one remedy for violation of a non-reviewed final Cease and Desist Order and a different remedy for viola-

tion of such a reviewed Order. The Wheeler-Lea Act does not provide that a District Court has power to issue an injunction to require compliance with or prohibit violation of either a reviewed or a non-reviewed Order. It would be strange to hold that a District Court had jurisdiction to enforce an order made by the Court of Appeals. Third, we are not as sure as appellee seems to be that the court's view of subsections (c) and (d) is correct, in light of the Supreme Court decision in the Jantzen case, 386 U.S. 228, 18 L.Ed.2d 11, holding that the Court of Appeals had jurisdiction under substantially identical Clayton Act provisions to enforce a final consent Cease and Desist Order, from which no petition to review had been filed, and which had become final more than six years before the petition for enforcement was filed.

Appellee's statement (Br. 27) that "appellants' whole case turns on the question of whether the Court of Appeals was vested with exclusive jurisdiction to enforce final Cease and Desist Orders" and on the Parkinson case, is completely erroneous.

It is appellants' contention that Congress has not vested District Courts with jurisdiction to enforce by injunction final Cease and Desist Orders, whether or not those Orders were reviewed by the Court of Appeals. The sole jurisdiction of the District Courts is imposition of pecuniary penalties under Section 5(L). Our contention would be the same if there were no subsections (c) and (d).

We think that the Parkinson decision is still the law and that it is not overruled or weakened by the DeMario case for the reasons stated in our opening brief (pp. 32-33).

Apparently, appellee has failed to understand the thrust of appellants' contention which we have just restated. Of course, when a petition to review a Cease and Desist Order is filed with the Court of Appeals, jurisdiction over the Order is transferred from the Commission to the Court, which has exclusive jurisdiction to make its own order enforcing or modifying the Commission Order (Br. 17-18, 21).

If, after the Order of the Court of Appeals is final, the Cease and Desist Order should be violated, what is the remedy? The pecuniary penalty provisions of Section 5(L) are not limited to non-reviewed final Cease and Desist Orders, but applies to all orders of the Commission "to cease and desist after it has become final, and while such order is in effect." (Sperry-Rand Corp. v. F.T.C. 288 F.2d, 403, 405). Subsections (g), (h), (i) and (j) of Section 5 specify when a Cease and Desist Order is final. Once that Order has become final, whether with or without appellate court review, the defendants are subject to the same and no different remedies or sanctions in the District Court, viz., the imposition of pecuniary penalties. The District Court has no more jurisdiction to issue an injunction against a respondent who did not file a petition for review than it does to issue one against a respondent who filed such a petition which resulted in an order for enforcement. The only difference between the two situations is that the respondent in a case reviewed by the Court of Appeals may be subject to contempt proceedings in that court for violation of the Court of Appeals order (but not for violation of the Commission order.)

Appellee has ignored and not commented upon appellants'

contention that whenever Congress intended to confer jurisdiction upon District Courts to grant injunctive relief, it has been careful to do so in specific language. In each such case, the statutes were specific in limiting the power to the grant of temporary restraining orders or preliminary injunctions to maintain the status quo pending the issuance of complaints by the Commission seeking adjudicatory relief. None of these statutes provided for final injunctions or for preliminary injunctions or temporary restraining orders in actions to recover pecuniary penalties for violation of final Cease and Desist Orders (Br. 21-22). It is not without significance that Congress has specifically vested District Courts with the power to issue injunctive relief for violations of the Sherman Act (15 U.S.C. §4) and the Clayton Act (15 U.S.C. §§25, 26). No similar provisions are found in the F.T.C. Act.

The Finality Act of 1959 (Section 11 of the Clayton Act, 15 U.S.C. §21) contains substantially identical procedural and penalty provisions to those in the Wheeler-Lea Act, but Section 15 of the Clayton Act likewise grants the equitable remedy of injunction. Could the Government have filed a civil penalty action against Jantzen in the District Court under Section 11(L) instead of applying to the Court of Appeals for an enforcement order? If it could, would the District Court have jurisdiction to issue an injunction or is its power limited to the imposition of a pecuniary penalty? If Jantzen should hereafter violate the Order, would the District Court have jurisdiction to issue an injunction enjoining Jantzen from violating the Cease and Desist Order issued in 1958? The case of F.T.C. v. Dean Foods Co., 384 U.S. 597, 16 L.Ed.2d 802, seems to lend some support to the

court's view that subsections (c) and (d) of Section 5 may apply only to the jurisdiction of Courts of Appeal in reviewed cases. In the Dean case, the Commission filed an application with the Court of Appeals for a temporary restraining order and preliminary injunction to enjoin the consummation of a merger which the Commission claimed was violative of Section 7 of the Clayton Act (15 U.S.C. §18). The court issued the temporary restraining order but after hearing, dissolved the same and denied the preliminary injunction upon the ground that no Cease and Desist Order had been entered by the Commission relative to the subject matter of the case and that the Commission had no authority to institute the proceeding in the Court of Appeals. The Supreme Court in a five to four decision reversed, although the principal holdings of the court were that the Commission had standing to file the petition and that the Court of Appeals had power to issue a preliminary injunction. The four dissenting Justices, in an opinion by Justice Fortas, considered at length the various statutory provisions of Section 11 of the Clayton Act and in this connection said, in a footnote at Page 616-617:

> "An FTC order under the Clayton Act is now final upon expiration of the time allowed respondent to seek judicial review. If he does not appeal the order and violates its terms after it becomes final, the Government may proceed, pursuant to statute (15 USC §§21(g) and (l), to seek civil penalties of up to $5,000 per violation.
>
> "In short, and contrary to the suggestion in the Court's opinion, the Commission's power to enforce compliance with its orders is and has been wholly

statutory. Nothing has been left to implication."

At Page 384, Justice Fortas said:

"By express statutory provision, even after a Commission order has been entered, the courts of appeals have no jurisdiction as to the merits of the merger, on application of the Commission. Only a party affected by the Commission's order may file a petition to review. If one does not, the Commission's sole remedy is to seek penalties in the district courts under 15 USC § 21(1).

"The statute contains its own 'all writs' provision which is clearly and specifically limited to instances in which the court of appeals' jurisdiction has already attached upon petition to review a Commission order filed by a person who is the target of that order."

These excerpts tend to support the view of the District Judge that jurisdiction of the Court of Appeals to enforce a Commission order vests only upon the filing of an application or petition with the Court of Appeals. They also support Appellants' position that the sole remedy for violation of a Cease and Desist Order "is to seek penalties in the District Courts" under Section 11(L) which is substantially identical with Section 5(L) (15 U.S.C. §§ 21(L) and 45(L)). We are not certain as to the weight that this dissenting opinion of the four Justices may have, but we find nothing in the majority

Appellee's statement (Br. 20-21, 27-28) that we cited Rule 81(b) F.R.Civ.P. to "support their arguments that the District Court has no equitable jurisdiction" is a clear and patent misstatement of appellants' position. We stated that Rule 81(b) "provides that writs of mandamus are abolished" in so far as the District Court's jurisdiction to issue them is concerned (Br. 35-36). Of course, District Courts have power to issue equitable writs and under Rule 65, this is clear as to injunctions. The fallacy of appellee's contention is that mandamus is a common law legal remedy and not an equitable remedy and hence, reliance by the court and appellee on the mandamus provision of Section 9 of the Act as providing the support for equitable injunctive remedy jurisdiction was misplaced and erroneous. We do not quarrel with the District Judge's statement (C.T. 106) that if the court had any equity jurisdiction in the case, all the inherent powers of an equity court were available to it, provided that such jurisdiction was invoked by proper pleading and proof. The mere fact that there may be a statute providing certain remedies, either legal or equitable, is not in itself sufficient. The remedy sought and granted must be specifically invoked by appropriate allegations and proof. But the court was in error in citing and relying upon the power to issue mandamus, a legal remedy, as conferring such equity jurisdiction.

Appellee has not questioned the authorities cited by appellant (Br. 35) that mandamus is a legal and not an equitable remedy and an application for such a writ is a legal and not an equitable proceeding.

The complaint does not purport to be a petition for a

writ of mandamus; it does not contain the usual allegations of a petition for mandamus (55 C.J.S., Mandamus, §§265-272). On the contrary, the complaint states that the plaintiff "brings this action to recover civil penalties" (C.T. 2:21-22).

The second contention summarized above (P. 1-2), that if the court had jurisdiction to issue an injunction, it was error to do so for the reasons there set forth, is based upon the proposition that there are no fact allegations, no evidence, and no findings with respect to those essential facts which are always deemed necessary to support injunctive relief, that is, allegations and evidence showing that in all probability the defendants would violate the order if not enjoined, damage, irreparable injury, and the other essential allegations noted in our opening brief (pp. 27-29). Appellee's statement (Br. 19) that the injunction was requested on the grounds defendants had repeatedly violated the Cease and Desist Order is not supported by the record. The complaint alleged but four violations with respect to advertisements of Herbold Pomade, all involving substantially the same advertisement, three allegedly committed on February 10, 1965, the subject of Counts Three, Four and Five, and one on August 27, 1965, the basis for Count Six.

In its Memorandum Opinion, the court cited the case of U. S. v. Vitasafe Corp., 234 Fed.Supp. 710, affirmed 352 F.2d 62, as authority for the injunctive power. We are advised by the attorneys for the defendant in that case that "the question of whether the court has the power to issue an injunction in a penalty action under Section 5(L) of the Act was not raised in that case and was never passed upon by the court."

II. SINCE THE COURT HAD NO JURISDICTION TO GRANT INJUNCTIVE RELIEF, IT WAS AN ABUSE OF DISCRETION TO DO SO.

Appellee's argument (pp. 17-20) that the allegations and findings that appellants violated the Cease and Desist Order by causing publication of the advertisements, pleaded in Counts Three to Six, are sufficient to support injunctive relief, is untenable.

Appellee alleged in three separate complaints that the action was brought "to recover civil penalties" (C.T. 2:21-22). Such penalties were the only specific relief sought in the three complaints. In appellee's motion for summary judgment on Counts Three to Six, the only relief requested and the only relief granted by the court was the imposition of pecuniary penalties of $500.00 on each Count, or a total of $2,000.00.

The complaint is devoid of allegations showing that it would be in the public interest to grant injunctive relief.

At the trial, appellee did not introduce any evidence whatsoever to prove the allegations of Counts Three to Six, because those counts were disposed of as to the corporate defendant on appellee's counter motion for summary judgment, which the court granted. The court held as a matter of law that some of the language in the advertisements, the subject of those counts, violated the Cease and Desist Order. Since the court, in so ruling, had already determined that the sole relief to be granted was the imposition of the pecuniary penalty, we do not understand the basis for later adding injunctive relief merely because appellee's attorney in argument requested it.

Appellee is correct in stating that at the trial it

"introduced nothing new in support of its request for an injunction" (Br. 18). This admission refutes appellee's own contention that the evidence was sufficient to sustain the grant of injunctive relief, because nothing further or additional by way of evidence was introduced at the trial justifying superimposing injunctive relief on the penalties already assessed.

Rule 65 F.R.Civ.P. provides that every temporary restraining order issued without notice "shall define the injury and state why it is irreparable." Here the permanent injunction was in effect issued without prior notice because it was not even mentioned until the closing arguments made by appellee's counsel. Rule 65(d) further requires that "every order granting an injunction . . . shall set forth the reasons for its issuance; shall be specific in its terms." The judgment does not meet these requirements, but merely states that plaintiff is entitled to an injunction (C.T. 97:20-25). This is insufficient. (See L. A. T. D. & Mortgage Exchange v. S.E.C. (9 Cir. 1959), 264 F.2d 199.)

Appellee's reference (Br. 18-19) to Rule 15(b) F.R.Civ.P. is misplaced, since no reference to an injunction was made until after the case was tried and being argued. The issue of the right to an injunction or the lack of pleadings or evidence to warrant the same were not tried by consent of the parties. (City Messenger of Hollywood, Inc. v. City Bonded Messenger, Inc., 254 F.2d 531, 537.)

Furthermore, no request to amend the second amended complaint was made, nor was any amendment filed.

III. THE PLEADINGS DO NOT ADMIT AND NO EVIDENCE WAS RECEIVED TO PROVE THAT THE ADVERTISEMENTS INVOLVED IN COUNTS THREE TO SIX WERE DISSEMINATED IN INTERSTATE COMMERCE.

Appellee's statement (Br. 5) that appellants admitted that the advertisements in Counts Three to Six were disseminated in interstate commerce is erroneous. Appellee's contentions that judicial notice was properly taken that these newspapers were circulated in interstate commerce and that appellants cannot raise the question of dissemination for non-compliance with Local Rule 3(g)2 are without merit.

Appellee's contention that appellants admitted the advertisements were disseminated in interstate commerce misstates the pleadings. The findings made on appellee's cross-motion for summary judgment do not find that the advertisements were disseminated within the District of Columbia (C.T. 78-91). The findings made after trial were based on taking judicial notice that the "Evening Star" and "Washington Post" "are circulated in interstate commerce" (C.T. 96:16-19, par. 7). The complaint alleges that on or about February 10, 1965 "defendants caused the dissemination of an advertisement of 'Herbold Pomade' in the March 8, 1965 issue of the Washington Post, a newspaper of interstate circulation published in Washington, D. C., and the April 5, 1965 issue of the Virginian Pilot, a newspaper of interstate circulation published in Norfolk, Virginia." (C.T. 6, par. 16, Count Three). The same allegations are made in Count Four (C.T. 6-7, par. 20) as to "The Evening Star", the "Virginian Pilot", "The Richmond Times Dispatch" and the "Beacon Journal"

Similar allegations are made in Counts Five (C.T. 8, par. 24) and Six (C.T. 9, par. 28) with respect to the newspapers there mentioned.

The answer to these paragraphs (C.T. 29-30, par. 8) as to Count Three, admits that the corporate defendant on February 10 transmitted a letter to the Peoples Drug Stores in Washington, D. C., requesting it to schedule for publication an advertisement for Herbold Pomade containing the language set forth in advertisement mats forwarded to the drug store, and gave the dates and names of the newspapers in which the advertisements were to be published. It admits on information and belief that Exhibit D is a true and correct copy "of the advertisements published" in the "Washington Post" and "Virginian Pilot" on the dates specified. The defendant "denies all allegations of Paragraph 16 not expressly admitted." Similar admissions and denials are made with respect to Count Four, (Par. 20 of Complaint; C.T. 30, par. 11 of the Answer), Count Five (Par. 24 of the Complaint; C.T. 37, par. 14 of the Answer) and Count Six (par. 28 of the Complaint, C.T. 32, par. 17 of the Answer).

The answer further denies the allegations of Paragraphs 18, 22, 26 and 30 that the defendants caused the dissemination in interstate commerce of the pleaded advertisements. The defendants likewise denied, by the language above quoted, that they caused the dissemination of the advertisements and issues of the newspapers pleaded in the complaint, and denied such newspapers were newspapers "of interstate circulation".

Whatever the definition of interstate commerce may be in the Act, "interstate" in its ordinary context means between places or persons in different states (48 C.J.S. 116), and "circulation"

means the passing of something from place to place or from person to person. In the absence of evidence that the specific issues of Washington, D. C. newspapers pleaded in the complaint did pass from the District of Columbia to other states, there was no evidence to support the finding of the trial court unless the doctrine of judicial notice supplied such proof.

The foregoing summary is given to show that appellee's statement that defendants admitted that the advertisements were disseminated in interstate commerce is incorrect.

Irrespective of the definition of commerce contained in the Act, the Commerce Clause of the Constitution only authorizes Congress to "regulate commerce with foreign nations, and among the several states, and with the Indian tribes". (Constitution, Art. 1, Sec. 8, Clause 3).

The authorities cited by appellee with respect to judicial notice require no attention. We have shown in our Opening Brief (pages 50-54) that judicial notice may be taken only of matters of such general knowledge and notoriety that it is common and everyday knowledge in the jurisdiction where the case is heard, of a certain fact. It may be doubted that it is general knowledge in California that the described newspapers are circulated in interstate commerce.

Appellee's statement that appellants cannot now raise the question of interstate commerce for failure to comply with Local Rule 3(g)2, is untenable. Appellee knows that: on September 16, 1966, appellants filed motions for summary judgment noticed for hearing on October 3, 1966 (C.T. 36-40). Appellants, in compliance with Local Rule 3, filed a statement of reasons in support

(C.T. 41-75), and proposed findings and judgment (C.T. 80-87). At appellee's request, appellants extended its time to October 10 and continued hearing on the motion to October 31, on which date it was again continued to November 28. At no time did appellee file any objections or response to appellants' motions for summary judgment and under the same rule relied upon by appellee, this could have been deemed an admission that the motions were well taken, and justified the court in granting the same.

Instead of filing opposition to appellants' motions for summary judgment, appellee on November 17 filed a cross-motion for summary judgment in its favor as to the corporate defendant only (C.T. 78).

On November 25, appellants filed a memorandum opposing plaintiff's cross-motion for summary judgment and in further support of appellants' motions, together with a statement of the defendants' reasons why plaintiff's motion should be denied, with an affidavit of Milton Herbold. These documents are not part of the record in this case and are, therefore, not properly before the court for its consideration. Since, however, appellee has seen fit to go outside the record and refer to other matters (Br. p. 8), appellants offer to show that in their reply memorandum appellants, at pages 3-4, in referring to the motions for summary judgment filed by appellants and stating that they were upon the grounds "that there was no genuine issue as to the material fact dispositive of the charges made, i.e., that the advertisements in question, if disseminated in interstate commerce, when fairly read and interpreted, did not violate the

there is no further issue to be tried. If the Court does not so conclude, then there does remain certain factual issues to be tried . . . As to Counts Three to Six inclusive, the factual issue would remain as to whether the advertisements were disseminated in interstate commerce".

Not only is appellee's statement patently incorrect, but the court chose to ignore appellee's failure to comply with the local rules, and heard and granted appellee's motion for summary judgment by construing the advertisements as containing language violating the Cease and Desist Order.

IV. THE COURT WAS WITHOUT SUBJECT MATTER JURISDICTION.

Appellee (Br. 14-17) attempts to support subject matter jurisdiction, which results from failure to allege and prove certification of the facts by F.T.C. to the Attorney General. The St. Regis case, 355 F.2d 688, flatly holds that certification is mandatory and failure to allege and prove certification deprives the court of jurisdiction. Lack of jurisdiction may be raised at any stage of the proceeding, even on appeal, by the court of its own motion. Appellants have no way of knowing whether such certification was or was not made. Appellee refers to an affidavit of Joseph S. Saunders (Br. 15) which appellee did not designate for inclusion in the record. The affidavit is nothing but conclusions in which he states that on December 10, 1964 the Commission certified facts to the Attorney General which it believed showed violations of the Cease and Desist Order and requested "that appropriate proceedings be instituted" and that the action filed on January 6, 1965 was commenced "pursuant

on the basis of the facts certified". Since the certification itself was not attached to the affidavit, we do not know what was contained therein. Since the original complaint filed contained but two counts against Milton Herbold only, and involved only the product known as Q. T. Color Balm, it is obvious that the second amended complaint filed on May 9, 1966, containing six counts, the first two of which were against the corporation only and the last four of which involved matters occurring subsequent to the filing of the original complaint, the certification could not have been the basis for the new allegations against new parties involving new transactions. If the required certification for these new charges was actually had, why did not appellee produce both certifications instead of relying upon the conclusory statements of an attorney in an affidavit?

V. THE FINDINGS THAT THE ADVERTISEMENTS IN COUNTS THREE TO SIX VIOLATED THE CEASE AND DESIST ORDER ARE REVIEWABLE WITHOUT REGARD TO THE CLEARLY ERRONEOUS RULE.

In answer to appellants' argument that the advertisements involved in Counts Three to Six did not violate the Cease and Desist Order (Br. 54-62), appellee relies solely upon Rule 52(a) F.R.Civ.P., which states that findings of fact shall not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge of the credibility of witnesses. It follows that if the rule is inapplicable, appellee has not disputed appellants' contention that the advertisements did not violate the Order.

cause it applies only to findings of fact, while the determination of the judge in the instant case, although labeled a finding of fact, is in reality a conclusion based upon the construction of a written instrument.

"The general rule is that it is the duty of the court to construe written statements and to determine the meaning of plain words in whatever form of writing contained." (9 Cyc. Fed. Proc. 1967 Rev. §31.58); West v. Smith, 101 U.S. 263, 25 L.Ed. 809; Richardson v. Boston, 60 U.S. 263, 15 L.Ed. 639; MacLaughlin v. Hull (9 Cir.), 87 F.2d 641, 644.)

This is a question of law for the court. (Crowe v. Gary State Bank (7 Cir.), 123 F.2d 513.)

The conclusion that the advertisements violated the Cease and Desist Order was based solely upon the judge's construction of the printed advertisements. No other evidence was presented to or considered by him. Under the rule of the cases heretofore cited (Op. Br. p. 55), the appellate court is in as good a position to construe the advertisements as was the trial judge.

The Lundgren v. Freeman case, 307 F.2d 104, at 115, cited by appellee notes that Ninth Circuit cases follow both the so-called Frank and Clark views. The Frank view cases were based on "inferences derived from application of a legal standard and not inferences derived from having had 'experience with the mainsprings of human conduct'". These comments are applicable here, for we are dealing with a conclusion based upon an application of a legal standard, to wit, the construction of a written instrument. This view, which was not involved in either the Stauffer Laboratories or the Duberstein cases, makes the clearly erroneous

finding is clearly erroneous and appellee has presented nothing to the contrary.

For each and all of the foregoing reasons, we submit that the judgment appealed from should be reversed.

Respectfully submitted,

J. E. SIMPSON
Attorney for Appellants

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules and that I was responsible for the preparation of the brief.

J. E. SIMPSON
Attorney

No. 22,106

IN THE

United States Court of Appeals

For the Ninth Circuit

CASA DORINDA ESTATES, also known as SANTA MARIA ACRES APARTMENTS, a copartnership, et al., Debtor,

Appellant,

vs.

ALL-YEAR WEATHER, INC.,

Appellee.

On Appeal from the United States District Court for the Central District of California

BRIEF FOR APPELLANT

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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vs.

ALL-YEAR WEATHER, INC.,

Appellee.

On Appeal from the United States District Court for the Central District of California

BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from an order entered on May 26, 1967 by the United States District Court for the Central District of California reversing the order of the Referee in Bankruptcy dated January 23, 1967, wherein appellee was restrained until further order of the Court, or until the final decree in the Chapter XI proceedings, from proceedings to foreclose its lien on appellant's property. The appellant, Casa Dorinda Estates, also known as Santa Maria Acres Apartments, a copartnership, initiated the above entitled

proceedings for an arrangement under Chapter XI of the Act of Congress Relating to Bankruptcy, 11 U.S.C. Sections 701-799, by filing its petition and schedules in said United States District Court on December 20, 1966. The Referee in Bankruptcy to whom said proceedings was referred by said Court issued on said date of December 20, 1966, upon appellant filing a petition therefor, an order to show cause to appellee and a number of other respondents directing them to appear before said Referee and establish the amount, validity, and priority of their respective liens upon appellant's property, and to show why, inter alia, they should not be restrained from commencing or proceeding any further with any foreclosure of their liens on appellant's property (C.T. pp. 2-13.) The said petition of appellant and the order to show cause issued thereon was duly noticed and heard by the Referee who made and entered findings of fact, conclusions of law, and an order on January 23, 1967 (C.T. pp. 25-31). Said order contained a provision restraining appellee and said other respondents from proceeding to foreclose on appellant's property. Appellee alone filed a petition to review said order of the Referee on February 2, 1967 (C.T. pp. 33-35). The petition to review was heard by the Honorable Charles H. Carr, Judge of said District Court, who made and entered an order on May 26, 1967, wherein that portion of the Referee's order restraining appellee was reversed (C.T. pp. 56-57). Appellant filed in this Court a timely notice of appeal from said order on June 28, 1967

(C.T. pp. 58-59). The jurisdiction of said District Court to entertain said Chapter XI proceedings, rests upon 11 U.S.C. Sections 701-799. The jurisdiction of the District Court to review the said order of the Referee rests upon 11 U.S.C. Sec. 67(a)(8). The jurisdiction of this Court to hear this appeal is based upon 11 U.S.C. Sections 47, 48 and 716 and General Order No. 36.

STATEMENT OF THE CASE

This appeal arises in a proceedings in bankruptcy wherein appellant, as debtor-in-possession under 11 U.S.C. Sections 742 and 743, filed a petition and had an order to show cause issue seeking to temporarily restrain its secured creditors from foreclosing on its real property, thereby giving it a reasonable time to realize upon its substantial equity in its said property and pay its secured and unsecured creditors in full and retain the excess for its own benefit and rehabilitation.

STATEMENT OF FACTS

Appellant is a partnership composed of Charles B. Herter, Jr., Evelyn F. Herter, Homer F. Barnes and Mary F. Barnes (R.T. 1/5/67, p. 11, Ex. E; R.T. 12/27/66, p. 80, lines 4-9).

The partnership acquired two contiguous parcels of real property consisting of approximately fifty

(50) acres in Montecito, California, a suburb of Santa Barbara, and had title thereto recorded in the names of Homer F. Barnes and Mary F. Barnes. On April 20, 1964 a deed of said property from the two Barnes to Charles B. Herter, Jr. and Evelyn Herter was recorded. (Ex. 6, R.T. 12/27/66, p. 42). On March 1, 1965, at a time when the record title was in the Herters' names, the Herters gave appellee, All-Year Weather, Inc., a deed of trust upon both of said parcels of real property (Ex. 3, R.T. 12/27/66 p. 35). Later the Herters redeeded the said real property to the Barnes who, in turn, deeded the property to the Security Title & Trust Company as trustee (Ex. 7, Ex. 1, R.T. 12/27/66 p. 23 line 5 to p. 24, line 8, Ex. 4). The Security Title and Trust Company held legal title to said real property as trustee for the partnership (Ex. 1, R.T. 12/27/66 p. 23, line 20 et seq. Ex. 4, C.T. p. 28, lines 7-17; C.T. p. 30, lines 25-28).

At all times since the acquisition of the property in the names of the various partners the appellant, as a partnership, was the owner of the beneficial interest therein. (R.T. 12/27/66 p. 95, lines 15-22; p. 100, lines 21-24; p. 88, line 22; p. 80, line 19; R.T. 1/5/67, p. 12, lines 3-10; p. 28, lines 18-21; C.T. p. 28, lines 2-6; p. 30, lines 1-5). At the time the debtor proceedings was originally filed in the District Court appellant had, and still has, possession of said real property (R.T. 12/27/66 p. 88, line 21-p. 89, line 7).

The real property is located in an exclusive residential area and is studded with black oak and is a fine piece of subdivision land (R.T. 12/27/66, p. 81, line 6; p. 83, line 7; Ex. A-D). Both parcels have a total value of $1,115,000.00 (R.T. 12/27/66 p. 83, lines 13-26). A portion of the property was previously sold by appellant for more than $24,000.00 per acre (R.T. 12/27/66, p. 87, lines 15-22). There now remains a fraction of an acre less than 50 acres (R.T. 12/27/66, p. 83, lines 19-23). The total of all liens against both parcels of real property is less than $450,000.00 (R.T. 12/27/66, p. 90, lines 10-23). Appellant has an equity of $665,000.00 in said real property (C.T. 12/27/66, p. 28, lines 18-25).

At the hearing upon appellant's petition and order to show cause before the Referee the attorney for appellee, All-Year Weather, Inc., made a conditional offer to deposit with the Referee a sum in the amount of $7,177.14 to be used to pay appellant's unsecured creditors. Such offer was expressly conditioned upon (1) the Court's dissolution of the temporary restraining order, (2) that no further stay be issued, (3) that no determination be made whether or not appellant was the owner of the real property, (4) that no determination be made whether the temporary restraining order legally stayed the lienholders' enforcement of their liens, (5) that the advance of the sum of $7,177.14 be considered an additional advance under appellee's trust deed, (6) that said advance be without prejudice to appellee's objection to jurisdic-

tion and to the granting of a stay order (R.T. 12/27/66, p. 6, line 4-p. 7, line 7). During said hearing before the Referee said attorney stated that dismissal of the Chapter XI proceedings was not a condition of his said offer (R.T. 12/27/66, p. 16, lines 18-20; p. 17, lines 12-13).

Upon the conclusion of the hearing, upon appellant's petition and the order to show cause the Referee made findings of fact (1) that appellant was a partnership, (2) that it was, and is, the owner of the real property, and (3) that the property has a value of $1,115,000.00, and that the total of all liens upon the property, including real property taxes, is less than $450,000.00 (C.T. p. 28, line 22).

At the hearing upon review before the District Court no further evidence was received. However, said District Court did purport to make findings of fact and entered them in the proceedings (C.T. pp. 52-54).

At the said hearing before the District Court upon the petition to review the Referee's order, appellee's attorney stated he had made an offer to pay all unsecured debts and made further statement at said hearing upon review that appellee would also pay the costs of administration (R.T. 5/1/67, p. 19, lines 10-15). The order signed and entered by the District Court provides that the Chapter XI proceedings shall be dismissed upon payment by appellee into Court of an amount sufficient to pay appellant's unsecured debts and the costs of administration (C.T. p. 57, lines 19-27).

SPECIFICATION OF ERRORS RELIED ON

1. The District Court erred in reversing the Referee's order restraining appellee from foreclosing on appellant's property.

2. The District Court erred in ordering the Referee to fix the reasonable costs of administration and to permit appellee to pay such costs, together with the sum of $7,177.14, and to thereupon dismiss the proceedings.

QUESTIONS PRESENTED

1. Were the findings of fact, conclusions of law and order of the Referee clearly erroneous?

2. Did the Referee clearly abuse his discretion in granting the restraining order?

3. Whether the rehabilitation of the debtor is included among the purposes of a proceeding for an arrangement under Chapter XI of the Act of Congress Relating to Bankruptcy?

4. Whether a proceedings for an arrangement under Chapter XI must be dismissed as a matter of law, or at all, if a secured creditor, who stands to forfeit a substantial equity in the debtor's property, offers to deposit an amount in Court sufficient to pay the costs of administration and debtor's unsecured creditors?

5. Does Section 323 of the Act of Congress Relating to Bankruptcy require a statement in a petition

filed by a partnership under Chapter XI that it and its individual partners are unable to pay the partnership debts as they mature?

SUMMARY OF ARGUMENT

The appellant, Casa Dorinda Estates, a copartnership, owned and was in possession of the real property involved before and at the time these proceedings were filed in the Bankruptcy Court. The Referee, sitting as the Bankruptcy Court, had jurisdiction to determine ownership of the property, the amount and validity of any and all liens thereon and upon notice and for cause shown, enjoin or stay until final decree any act or the commencement or continuation of any proceeding to enforce any lien upon the property of the debtor. The granting or denying a petition for a restraining order is a matter that lies within the sound discretion of the Referee. Any order of a Referee upon a matter that lies in his discretion should not be reversed unless it is clearly erroneous and is an abuse of such discretion. The Referee's order is fully supported by findings of fact and conclusions of law that are based upon substantial uncontradicted evidence.

The fact that the Debtor is the owner of the property and has an equity therein of $665,000.00 over and above all liens, including that of appellee, is clearly established by said findings of fact and substantial uncontradicted evidence.

The purpose and intent of a Chapter XI proceedings is to rehabilitate the debtor and to preserve the equities that the debtor may have in its property for the benefit of the debtor as well as to provide for the payment of creditors. "Providing a means of relief and rehabilitation to debtors is the common principal purpose of Chapters X, XI, XII and XIII of the Bankruptcy Act." (*Hallenbeck v. Penn Mutual Life Ins. Co.,* 4 Cir., 323 F. 2d 566, 570). The payment of creditors is not the sole purpose of the chapter. The jurisdiction and powers granted the Bankruptcy Court by Chapter XI may be utilized to rehabilitate the debtor and preserve its equities in its properties for its benefit, provided that all the elements for such a proceeding under that Chapter were present at the time of the original filing of the proceedings in the Court.

Debtor respectfully submits that the findings of fact and conclusions of law made by the Referee are supported by substantial evidence, are not clearly erroneous and that the Referee's order restraining appellee from proceeding to foreclose upon debtor's property was not an abuse of his discretion.

ARGUMENT

A. THE DISTRICT COURT ERRED IN REVERSING THE REFEREE'S ORDER RESTRAINING APPELLANT FROM COMMENCING FORECLOSURE PROCEEDINGS.

1. The Bankruptcy Court has jurisdiction of Debtor and its property.

Appellant is a copartnership and as a copartnership it owned the real property involved in these proceedings. A copartnership may own real property although legal title may stand of record in the names of individual partners.

In 37 *Cal. Jur.* (2d), at page 597, it is stated:

> "Real property may be owned by a partnership though the title is in the individual names of the partners."

In 37 *Cal. Jur.* (2d), at page 593, it is stated:

> "The Uniform Partnership Act provides that all property originally brought into the partnership, or subsequently acquired by purchase or otherwise, on account of the partnership, is partnership property. It further provides that, unless the contrary intention appears, property acquired with partnership funds is partnership property. This result follows, moreover, in spite of the fact the property may be bought in the individual names of the partners. Nor is it necessary to show that partnership property was purchased with partnership funds. Lands standing in the name of an individual partner may have been contributed by him as his portion of the firm assets."

Accord:

Swarthout v. Gentry, 62 C.A. (2d) 68;
Bennett v. Bumb, 51 Cal. (2d) 294.

The evidence in this matter that appellant is the owner of the property is uncontradicted (R.T. 12/27/66, p. 95, lines 15-22; p. 100, lines 21-24; p. 80, line 19; R.T. 1/5/67, p. 12, lines 3-10; p. 28, lines 18-21). Athough the record title at the time these proceedings were originally filed stood in the name of Security Title and Trust Company, Trustee, the evidence is uncontroverted that said company held legal title in trust for the partnership (Ex. 1; R.T. 12/27/66, p. 23, line 10 et seq.). An order has been made and entered upon due notice to said company that said real property is the property of appellant (C.T. p. 28, lines 7-17; p. 30, lines 25-28). There is more than substantial evidence in the record to support these findings and said order.

Appellant was in possession of the real property when the proceedings under Chapter XI was filed (R.T. 12/27/66, p. 88, line 21; p. 89, line 7). The Bankruptcy Court has exclusive jurisdiction over every debtor and its property in every Chapter XI proceedings.

11 *U.S.C.* 711, provides:

> "Where not inconsistent with the provisions of this chapter, the Court in which the petition is filed shall for the purpose of this chapter, have exclusive jurisdiction of the debtor and his property, wherever located."

The Referee, sitting as the Bankruptcy Court, also had jurisdiction, upon notice and for cause shown, to restrain any commencement or continuation of any foreclosure proceedings upon appellant's property.

11 *U.S.C.* 714, provides in part:

> "The Court may . . . upon notice and for cause shown, enjoin or stay until final decree any act or the commencement or continuation of any proceedings to enforce any lien upon the property of a debtor."

The Referee did, upon notice and for cause shown, enjoin further foreclosure proceedings.

2. The granting or denying a petition or application for a restraining order is a matter that lies within the discretion of the Referee.

In 8 *Collier on Bankruptcy,* 14th Ed. Sec. 3.20(3), at page 254, it is stated:

> "The granting or withholding of an injunction is left to the discretion of the Court."

In 9 *Remington on Bankruptcy,* at page 223, it is stated:

> "From the foregoing it is obvious that the courts exercised a considerable amount of discretion as to issuance or denial of injunctions or stay orders in connection with Section 74 proceedings, and from the purpose and language of Section 314 it would seem to be clear that at least the same amount of discretion rests in the court in a Chapter XI proceedings."

In *Continental Illinois Natl. Bk. v. Chicago Rock Island & Pac. Ry. Co.,* 294 U.S. 648, 680, 55 S. Ct. 595, 79 L. Ed. 1110, 1127, at page 1129, it is stated:

> "A claim that injurious consequences will result to the pledgee or mortgagee may not, of course, be disregarded by the district court; but it presents a question addressed not to the power of the Court but to its *discretion* (emphasis added) . . . a matter not subject to the interference of an appellate court unless such discretion be improvidently exercised."

And at page 1131:

> "The injunction here goes no further than to delay the enforcement of the contract. It affects only the remedy."

3. The Referee did not abuse his discretion in granting the restraining order.

Upon an appeal from or review of a Referee's order his order is to be affirmed unless it appears that his findings of fact, conclusions of law, or order is clearly erroneous, or that he has clearly abused his discretion in granting the order. The power of a District Court upon review of a Referee's order is identical with that of an Appellate Court upon an appeal.

In *Lines v. Falstaff Brewing Co.,* 9 Cir., 233 F. 2d 927, at page 930, it is stated:

> "General Order in Bankruptcy No. 47, 11 U.S.C.A. following section 53, reads as follows:
>
> 'Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and

conclusions of law, *and the judge shall accept his findings of fact unless clearly erroneous* (Court's emphasis) . . ., . . . Similarly, this court may not set aside the findings of the referee unless they are clearly erroneous.'"

At page 932:

"At this juncture it might be well to pause and reflect upon the precise meaning of 'discretion' —a convenient expression frequently used, but not often defined. In *Delno v. Market St. Ry. Co.,* 9 Cir. 1942, 124 F. 2d 965, 967, this Court thus expatiated on the subject:

'In a second sense, and the one most commonly meant in the use of the word in the law, "discretion" is defined as: "The power exercised by courts to determine questions to which no strict rule of law is applicable but which, from their nature, and the circumstances of the case, are controlled by the personal judgment of the court." 1 *Bouv. Law Dict., Rawles Third Revision,* p. 884. Judicial action—discretionary in that sense—is said to be final and cannot be set aside on appeal except when there is an abuse of discretion. A common example is a court's ruling on the extent of cross-examination. Discretion in this sense, is abused when the judicial action is arbitrary, fanciful or unreasonable, which is another way of saying that discretion is abused ONLY (Court's emphasis) where no reasonable man would take the view adopted by the trial court. *If reasonable men could differ as to the propriety of the action taken by the trial court, then it cannot be said that the trial court abused its discretion.*' (Court's emphasis) *Since the pow-*

er of review entrusted to a District Court vis-a-vis the findings of a referee is identical with that of a court of appeals with respect to the findings of a District Court (emphasis added) the above excerpt is apposite here. In each case, the findings are not to be set aside unless clearly erroneous."

Accord:

Snider v. England, 9 Cir., 374 F. 2d 717;
Lundgren v. Freeman, 9 Cir., 307 F. 2d 104.

Rule 52(a) *Federal Rules of Civil Procedure* provides in part:

"Findings of fact shall not be set aside unless clearly erroneous . . . ."

General Order No. 47 of *General Orders in Bankruptcy* provides in part:

"Unless otherwise directed in the order of reference the report of a referee . . . shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous."

The Referee may, in his discretion issue an order enjoining the enforcement or foreclosure of a lien to protect and preserve an equity in a debtor's property for *the benefit of the debtor* as well as the creditors of the debtor's estate.

In *In re Brown,* 7 Cir., 84 F. (2d) 433, at page 434, it is stated:

"A court of equity, however, has the power to enjoin the holders thereof from an immediate sale, *if such sale will operate to the injury of the*

DEBTOR (all emphasis added) as well as to other creditors. This power is given the Court upon the theory that there may be an *equity* (emphasis added) in the pledged security over and above the amount of the indebtedness secured thereby, and *that such equity will inure to the benefit of the debtor and of his other creditors.* (emphasis added)"

4. The Rehabilitation of a debtor is a primary purpose of a Proceedings under Chapter XI.

The payment of creditors is not the sole purpose of a proceeding for an arrangement under Chapter XI of the Act of Congress Relating to Bankruptcy. The ultimate goal of the proceedings is the rehabilitation and continued existence of the debtor as well as payment of creditors. A Referee may, in his discretion, issue an order restraining enforcement of liens to accomplish this purpose.

In *Nicholas v. United States* (1966), 384 U.S. 678, 86 S.Ct. 1674, 16 L. Ed. 2d 853, at page 861, it is stated:

> "The allowance of interest on Chapter XI debts until the filing of a petition in bankruptcy promotes the availability of capital to a debtor in possession and enhances the likelihood of achieving *the goal of the proceeding, the ultimate rehabilitation of the Debtor.*" (emphasis added)

In *In re International Swimming Pool Corp.,* 186 F. Supp. 63, at page 66, it is stated:

> "The purpose of a proceeding under Chapter XI is to give the debtor a reasonable opportunity to rehabilitate itself despite the fact that some

losses may be sustained in the transitional period."

In *Hallenbeck v. Penn Mutual Life Ins. Co.,* 4 Cir., 323 F. 2d 566, at 570, it is stated:

"Further, Section 614 of the Bankruptcy Act (11 U.S.C.A., Section 1014) specifically provides that, 'upon notice and for cause shown', the court may enjoin or stay 'any proceedings to enforce any lien upon the property of the debtor.' These provisions not only authorize, but *require* (emphasis added) that the court retain jurisdiction of any property, including, if such there be, *an equity of redemption in real estate for the benefit of the estate of the debtor under Chapter XIII.* (emphasis added) . . . Providing a means of relief and *rehabilitation to debtors* (emphasis added) is the common *principal purpose* (emphasis added) of Chapters X, XI, XII, and XIII of the Bankruptcy Act. Examination and comparison of the structures and specific provisions of these chapters reveal many similarities."

And at page 571:

"Notwithstanding the fact that Chapter XI pertains exclusively to *unsecured* (court's emphasis) debts, it has been held repeatedly that the bankruptcy court, acting by and through the Referee, has the discretionary power to enjoin proceedings to foreclose deed of trust or mortgage liens upon both real and personal property belonging to the debtor. In addition to recognizing and giving effect to the plain provisions of the statute granting the injunctive power, *the rationale of such decisions is that the legislation is remedial in*

nature; it should be liberally construed to effect its purpose: i.e., relief to and REHABILITATION of debtors; (all emphasis added) and it is quite apparent that in certain instances the power to enjoin foreclosure proceedings may properly be used to further that purpose. . . . we hold that the statutes comprising Chapters X, XI, XII and XIII of the Bankruptcy Act are in pari materia and that the constructions so uniformly given to Sections 311 and 314 of Chapter XI should be equally applicable to Sections 611 and 614 of Chapter XIII of the Act."

Accord:

Continental Illinois Natl. Bk. v. Chicago Rock Island & Pac. Ry. Co. (supra), 294 U.S. 648, 680; 55 S. Ct. 595; 79 L.Ed. 1110.

5. It is not required that the proceedings under Chapter XI be dismissed upon the payment into Court of an amount sufficient to pay unsecured creditors and costs of administration.

As hereinabove set forth, the payment to creditors is not the sole primary purpose of a proceedings under Chapter XI. The proceedings can also serve to rehabilitate the debtor and thereby permit it to remain in existence as a member of the business community. A debtor is entitled to all the benefits of the provisions of Chapter XI if it was qualified to file a proceeding under said Chapter as of the time the proceedings were originally filed. Any person, including partnerships, who could become a bankrupt, is entitled to file a proceedings under Chapter XI of the Bankruptcy Act.

6. A partnership may file a Chapter XI proceedings and there is no requirement of a statement that it and its partners are unable to pay the partnership debts as they mature.

11 *U.S.C.* 706 provides in part:

"For the purposes of this Chapter (XI), unless inconsistent with the contest . . . (3) 'debtor' shall mean a person who could become a bankrupt under Section 4 of this Act and who files a petition under this chapter; . . ."

In 1 *Collier on Bankruptcy,* 14th Ed. Sec. 4.12, at page 607, it is stated:

"A partnership is a 'person' with the definition of that term as contained in Sec. 1(23), and hence comes clearly within the voluntary provisions of Sec. 4."

11 *U.S.C.* 722 provides:

"If no bankruptcy proceedings is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication."

11 *U.S.C.* 723 provides:

"A petition filed under this chapter shall state that the *debtor* (emphasis added) is insolvent or unable to pay his debts as they mature, and shall set forth the provisions of the arrangement proposed by him, or, that he intends to propose an arrangement pursuant to the provisions of this chapter."

For the purposes of a Chapter XI proceedings a partnership, as such, is fully qualified as a "debtor" separate and apart from its partners. A partnership

alone may file a proceedings for an arrangement under said Chapter and for this purpose it is considered as a complete separate legal entity separate and apart from its partners. In such proceedings only its debts, its assets, and *its* ability to pay its debts as they mature will be considered. It is immaterial whether or not the individual partners also file proceedings for an arrangement of their individual obligations.

In 8 *Collier on Bankruptcy,* Sec. 4.02 (4), at page 365, it is stated:

> "A partnership may file a petition for relief under Chapter XI."

At page 366:

> "A partnership may file a Chapter XI petition in its *separate* (emphasis added) behalf. In proceedings under Chapters I to VII, a partnership may be adjudged a bankrupt either separately or jointly with one or more of all of its general partners. Since a partnership may become a bankrupt alone, it may therefore file a Chapter XI petition alone, and it is immaterial that the partners do not file a petition proposing an arrangement for their individual debts. In many situations, *including this* (emphasis added), a partnership is in bankruptcy a *legal entity* (emphasis added) apart from its individual members . . ."

Since a partnership may file a proceedings under Chapter XI as a separate legal entity apart from its individual members, only the inability of the partnership to pay its debts as they mature is germane to

its proceedings under Chapter XI. It is immaterial whether or not the individual partners had the ability to pay the partnership debts as they matured.

B. THE DISTRICT COURT ERRED IN ORDERING THE REFEREE TO DETERMINE THE COSTS OF ADMINISTRATION AND TO PERMIT APPELLEE TO PAY THIS SUM, TOGETHER WITH FUNDS TO PAY UNSECURED CREDITORS, AND THEREUPON DISMISS THE PROCEEDINGS.

1. Appellant should not be deprived of the benefits of Chapter XI.

As stated, a primary purpose of a Chapter XI proceedings is to rehabilitate the debtor, thereby greatly benefiting the debtor. Appellant was fully qualified as a debtor under the chapter as of the date of filing these proceedings and at all times since. Appellant is entitled to receive the rehabilitation benefits of a Chapter XI proceedings. It should not be deprived of this benefit by the offer of an excessively secured creditor to loan or advance it sufficient money to pay unsecured creditors and costs of administration upon condition that the secured creditor be left free to foreclose upon the very substantial equity in appellant's property.

2. Appellee will suffer no substantial injury if the order restraining its foreclosure is continued in effect.

There is substantial corroborated uncontroverted evidence in the record supporting the Referee's finding to the effect appellant has an equity of $665,000.00 in its real property (R.T. 12 27/66 p. 83, lines 19-26; p. 85, lines 14-24; p. 86, lines 3-26; p. 87, lines 12-22;

p. 90, lines 20-24; C.T. p. 28, lines 18-23). The only detriment that will accrue to appellee by virtue of the stay order is the accrual of interest on the secured debts and taxes on the property, which would reduce appellant's equity in its property. If such stay order was continued in effect over an extended period of time it is possible that at some point appellee would no longer be fully secured. Interest is accruing on the secured indebtedness at the rate of approximately $2,000.00 per month (R.T. 12/27/66 p. 5, lines 2-9; p. 4, lines 11-24; R.T. 1/5/67 p. 2, line 3). Appellant is receiving income from the property of approximately $1400.00 per month (R.T. 12/27/66 p. 64, lines 19-24). This income should offset a substantial portion of, if not all, taxes accruing on the property. There is no evidence in the record as to the amount of the yearly taxes. But even assuming that an additional amount of taxes of $1000.00 per month is accruing this would make a total monthly amount of $3000.00 per month of interest and taxes accruing. Appellant has an equity of $665,000.00 in its property over and above all liens and taxes presently owed. Therefore appellee will be fully secured for more than 200 months, or 16 years. Appellant is requesting a restraining order only for a miniscule part of this period. Since the equity in appellant's property is more than adequate to keep appellee fully secured at all times appellee will suffer no substantial injury by a delay for a reasonable period in foreclosing on the property. It has been held that if a debtor has sufficient equity in its property to keep a secured creditor fully secured that the

secured creditor does not legally suffer any substantial injury by a reasonable delay under a restraining order.

In *In re Atlantic Steel Products Corporation,* 31 F. Supp. 418, at page 410, it is stated:

> "Clearly in the case at bar, the equities favor the debtor, because the value of the property is much greater than the amount of the chattel mortgage; therefore, the petitioner was not injured by the stay . . ."

Accord:

In re Brown (supra), 84 F. 2d 433, 434.

CONCLUSION

Appellant is fully qualified as a debtor under Chapter XI of the Bankruptcy Act. The Referee, sitting as the Bankruptcy Court, clearly has jurisdiction over appellant, and the property involved including jurisdiction, in his discretion, to enjoin foreclosure of liens on the property. The Referee's findings of fact, including the one that appellant has a substantial equity in its property, is more than adequately supported by substantial evidence. The granting or denying of appellant's petition for a restraining order is a matter that lies in the sound discretion of the Referee. The facts and equities of this case clearly support the granting of the stay order. The order of the Referee was by no means clearly erroneous and was not an abuse of the Referee's discretion. Appellant was entitled to the benefits provided for debtors by Chapter XI when it filed

these proceedings. It cannot be deprived of these benefits by appellee's conditional offer to loan or advance funds to it. Appellant should be granted a reasonable time to work out an arrangement to pay its creditors and not be forced to accept this advance and its proceedings dismissed so appellee can foreclose on its property.

Appellant respectfully submits that the District Court erred in reversing the order of the Referee restraining foreclosure proceedings by appellee and in remanding the matter to the Referee with instructions to determine the costs of administration and upon payment thereof, together with the amount of the unsecured debts, to dismiss the chapter proceedings, and appellant respectfully requests that this order of the District Court be reversed.

Dated, Fresno, California,
December 6, 1967.

W. A. McGugin,
Attorney for Appellant.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

W. A. McGugin,
Attorney for Appellant.

(Appendix Follows)

Appendix

Appendix

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W. A. McGugin
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No. 22,106

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CASA DORINDA ESTATES, also known as SANTA MARIA ACRES APARTMENTS, a copartnership, *et al.*, Debtor,
Appellant,

vs.

ALL-YEAR WEATHER, INC.,
Appellee.

On Appeal From the United States District Court for the Central District of California.

APPELLEE'S BRIEF.

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No. 22,106

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CASA DORINDA ESTATES, also known as SANTA MARIA ACRES APARTMENTS, a copartnership, *et al.*, Debtor,
Appellant,

vs.

ALL-YEAR WEATHER, INC.,
Appellee.

On Appeal From the United States District Court for the Central District of California.

APPELLEE'S BRIEF.

Statement of the Case.

This is an appeal from the District Court's Order [C. T. 56], reversing the Referee's award of an 11 U.S.C. § 714 injunction, which restrained enforcement of trust deed liens [C. T. 25], and remanded the Chapter XI proceedings to the Referee to allow Appellee to pay the Debtor's unsecured debts and expenses of administration so that the proceedings could be dismissed as moot [C. T. p. 57, lines 16-26].

Appellee made a loan to Charles B. Herter and Evelyn F. Herter, the record owners of fifty (50) acres of land in Montecito, California [Ex. 6], upon the Herters' representation of ownership [Ex. 4, ¶ 1a]. The loan was evidenced by Herters' Promissory Note for

$107,621.44, secured by a *third* trust deed upon the land [Exs. 3, 4, 5].

Upon default on the second trust deed [R. T. 12/27/66, p. 4], and a scheduled trustee's sale [R. T. 12/27/66, pp. 70-71], the Herters, Homer F. Barnes and Mary F. Barnes filed a Debtor's Petition and a Petition for a Restraining Order claiming that: they were partners, dba "Case Dorinda Estates;" the land belonged to the partnership; the land was worth $800,000.00 more than the four trust deeds against it; and the partnership had $7,177.14 in unsecured debts it could not pay [C. T. 2], together with a Proposed Plan of Arrangement calling for restraint of lien enforcement over a six-year payoff of the $7,177.14 in unsecured debts. A Temporary Restraining Order and Order To Show Cause was issued [C. T. 10].

Appellee filed papers in opposition [C. T. 14], pointing out that: the alleged partners were individually solvent; that the land was not the partnership's, and was not necessary, in any event, to any arrangement; that substantial injury would result to Appellee lienor; and that the "Plan" was not fair [C. T. 15-16].

At the hearing, Appellee offered to pay all the unsecured debts forthwith, and tendered a cashier's check for $7,177.14 [R. T. 12/27/66, pp. 6-17; Ex. 9 I.D.]. The Referee ruled that he lacked jurisdiction to accept it [R. T. 12/27/66, p. 17]. Appellee then called Charles B. Herter, Jr., as an adverse witness and established that Security Title Insurance Company (not "Casa Dorinda Estates") was the record owner of the land [R. T. 12/27/66, pp. 22-23; Ex. 1]; but was precluded from showing that "Casa Dorinda Estates"

had not filed a fictitious name certificate [R. T. 12/27/66, pp. 24-25].

Herter admitted that he had assets of his own* not included in the Debtor's Petition [R. T. 12/27/66, p. 27, lines 8-11]. The objection that further inquiry into the individual partners' assets was immaterial was sustained [R. T. 12/27/66, pp. 27-28]. Appellee offered to prove that the individual partners were solvent [R. T. 12/27/66, p. 28, lines 13-19]. The Referee held such offer to be immaterial [R. T. 12/27/66, p. 28, lines 20-21].

Herter testified that in his opinion the land was worth $1,200,000 and the equity (after 4 trust deeds and unpaid taxes) was $700,000-$800,000 [R. T. 12/27/66, pp. 83-91].

No proof was offered as to the necessity of the land to carry out the 6 year plan to pay off the $7,177.14 in unsecured debts.

Finding that the partnership owned the land, in which it had a substantial equity, the Referee granted the injunction [C. T. 25] "until further order of the above-entitled Court, or the final decree in these Chapter XI proceedings" [C. T. 31]. He did *not* find that the land was needed for the success of the Chapter XI proceedings, or as to either of Appellee's offers (payment of unsecured debts; individual partners' solvency). Nor did he find that the injunction would not cause injury to Appellee.

The District Court found that the Referee had "abused his discretion" in awarding the injunction, and

*Including an airplane which he used like an ordinary man uses an automobile [R. T. 12/27/66, p. 47, lines 13-21].

concluded that the Referee erred in excluding proof of the partners' individual solvency, and erred in refusing to accept Appellee's offered payment [C. T. 52-55]. Whereupon the Court made the order herein challenged [C. T. 56].

Questions Presented.

1. What are the criteria for the award or denial of an 11 *U.S.C.* § 714 injunction restraining secured creditors' enforcement of their liens?

2. What is the scope of the court of appeals' review of a district court's findings that a referee "abused his discretion" in awarding an 11 *U.S.C.* § 714 injunction?

3. What is the scope of a district court's review of a referee's order awarding an 11 *U.S.C.* § 714 injunction; *i.e.* does the "clearly erroneous" rule apply to the referee's conclusion that an injunction is justified?

4. What is the effect of a district court's findings on issues material to the award of an 11 *U.S.C.* § 714 injunction the referee has failed to find upon?

5. May holders of secured liens against land who dealt with the record owner be enjoined pursuant to 11 *U.S.C.* §714 on the claim of such owner that the land was and is owned by a secret partnership which is now insolvent?

6. May a Chapter XI partnership whose partners are solvent be awarded on 11 *U.S.C.* §714 injunction?

7. Is a partnership entitled to a Chapter XI proceedings to "rehabilitate" itself where the partners are solvent?

8. Is a partnership whose individual members are solvent entitled to a Chapter XI proceedings to "rehabilitate" itself after a secured creditor offers to pay all unsecured debts and the reasonable expenses of administration?

Summary of Argument.

All injunctions call for the exercise of a delicate and sweeping power and should be awarded only in clear cases.

Injunctions awarded under 11 *U.S.C.* §714 must rest upon findings that the injunction is necessary for a fair and equitable plan to pay the unsecured creditors of an insolvent Debtor and will not cause substantial injury to the enjoined lienor.

Where, as here, a secured creditor offered to pay all unsecured creditors in full, forthwith, and the referee made no findings as to: (1) necessity of the injunction to safeguard the unsecured creditors; (2) fairness of the plan proposed; (3) solvency of the individual members of the Debtor partnership, the District Court was justified in making findings of its own on such material issues, reversing the Referee's award of an injunction and remanding the proceedings.

In such a case, the question is not whether the Referee's inadequate findings and conclusion that injunction should issue were "clearly erroneous"—the question is whether the District Court's findings are "clearly erroneous".

For "discretion" exercised on an imperfect grasp of the equitable and legal criteria for an 11 *U.S.C.* §714 injunction is not entitled to any weight whatsoever.

ARGUMENT.

A. The District Court Correctly Held, Under the Circumstances and the Law Governing 11 U.S.C. §714 Injunctions, That the Referee "Abused His Discretion" in Granting an Injunction.

1. Preliminary Statement.

11 *U.S.C.* §714 provides in relevant part:

> "The Court *may* . . . for cause shown, enjoin . . . any proceedings to enforce any lien upon the property of a debtor." (Italics ours).

Thus, in Chapter XI proceedings, the referee is granted the "power of imposing magnitude" (*Suhl v. Bumb,* 348 F. 2d 869, 871, 9 Cir.) of summarily restraining the normal enforcement of secured liens.

Such power is, however, to be sparingly exercised and then only when necessary to carry out the primary purpose of a Chapter XI proceeding—the payment of unsecured creditors.

> *In re Tracy,* 194 F. Supp. 294, N.D. Cal. 1961; *In re Brown,* 84 F. 2d 433.

As in all cases where an injunction is sought, an 11 *U.S.C.* §714 injunction should not be granted in doubtful cases.

> *Dyno Industries, Inc. v. Tapeprinter, Inc.,* 326 F. 2d 141, 143, 9 Cir., 1964.

As a general rule, appellate courts view the grant or denial of a prohibitory preliminary injunction as resting in the sound judicial discretion of the trial court, and limit determination on appeal to whether there has been "abuse of trial court discretion", "clear error,"

"violation of the rules of equity," or "improvident granting."

Maas v. United States, 371 F. 2d 348, C.A.D.C. 1967 (and cases cited).

These considerations are particularly cogent when, as here, the injunction was not merely *pendente lite,* but "until further order of the above-entitled Court, or the final decree in these Chapter XI proceedings" [C. T. 31] (which, under the Debtor's Proposed Plan of Arrangement would be six (6) years from the approval of the Plan), and such "Plan" was not fair and equitable to unsecured creditors when compared with Appellee's offer to pay such debts in full, forthwith. (*Case v. Los Angeles Lumber Products Co.,* 308 U.S. 106, 114).

The Referee erroneously concluded that, in deciding whether an 11 *U.S.C.* § 714 injunction should issue, his inquiry should begin and end with the question of whether there was some equity in the property [R. T. 12/27/66, p. 30, line 18, to p. 31, line 1; R. T. 1/-5/67, p. 58, line 16, to p. 60, line 6]. Thus, his only finding relevant to the injunction was that there was a "substantial equity" [C. T. 28, lines 18-25].

The "adequate security" argument is also heavily relied upon by Appellant (Brief, pp. 21-23).

But the adequacy or inadequacy of the Appellee's security alone is "too narrow" a basis on which to grant or deny an 11 *U.S.C.* § 714 injunction.

As the Court pointed out in the case of *In re Empire Steel Company,* 228 F. Supp. 316, 319, D. Utah, 1964:

". . . If there is no possibility of submitting a plan except upon the happening of some future con-

tingency, the basis for any protracted stay simply does not exist. Otherwise, secured creditors could be indefinitely delayed, for almost every debtor hopes that something may happen in the future to relieve his plight and permit him to avoid foreclosure. Chapter XI would become simply authority for general moratoria against secured creditors rather than a means to permit appropriate submission, processing and consideration of plans of adjustment. The 'status' of secured creditors then unavoidably would be affected, for status depends not only upon assurance of eventual payment but the right to payment or enforcement in point of time bearing some relationship to the conditions of the security instruments."

* * * * *

"The Referee's consideration of the propriety of the stay was too narrow. The adequacy or inadequacy of the government's security was only one of the questions upon which a decision should have been predicated."

2. The "Clearly Erroneous" Rule.

It is, of course, plain that a referee's findings are subject to the "clearly erroneous" rule, and that a district judge should accept them unless there is no substantial evidence to support them, or unless the judge is left, after a review of the entire record, with the definite and firm conviction that the findings are wrong.

Rule 52(a), *F.R.C.P.;*

General Order No. 47 of *General Orders in Bankruptcy;*

United States v. United States Gypsum Co., 333 U.S. 364, 395.

Further, although there is some conflict among the circuits as to the scope of review in the court of appeals where the district court rejects the findings of the referee and reverses his order (*2 Collier on Bankruptcy,* 14th Ed., p. 973, Fn 23, Sec. 25.30), this court has expressed a policy of "judicial restraint" in this area.

Olympic Finance Co. v. Thyret, 337 F. 2d 62, 9 Cir. 1964.

On the other hand, if, as here, the case turns, *not* on the District Court's rejection of the Referee's findings of fact based on conflicting evidence or testimonial credibility, but upon the referee's *conclusion* from the facts found, the district judge is free to find on material issues the Referee ignored, find an "abuse of discretion", and reach a different conclusion than the referee did.

Costello v. Fazio, 256 F. 2d 903, 908, 9 Cir. 1958;

Olympic Finance Co. v. Thyret, supra.

What the district court rejected here was not the skimpy facts found by the referee [*i.e.* the "substantial equity" finding, C. T. 28], but the referee's *conclusion* that it was proper, notwithstanding the offer of proof as to the individual partners' solvency, etc. [R. T. 12/27/66, p. 28] and Appellee's offer to pay all the unsecured creditors, to grant such an "open-end" injunction.

3. The Scope of a Referee's "Discretion" to Enjoin the Enforcement of Secured Liens Under 11 U.S.C. §714.

It is well-settled that a referee's "discretion" to grant injunctions under 11 *U.S.C.* §714 is contingent upon two things:

1. Such injunction is "necessary to facilitate the primary purpose" of the Chapter XI proceedings (the payment of unsecured creditors); and,
2. The injunction "does not cause substantial injury to the lienor."*

In re Tracy, 194 F. Supp. 293, N.D. Cal. 1961;
Chaffee County Fluorspar Corp. v. Athan, 169 F. 2d 448, 10 Cir., 1948;
In re Holiday Lodge, Inc., 300 F. 2d 516, 7 Cir., 1962.

The Referee here did not make either findings or conclusions as to either one of these jurisdictional conditions precedent to his exercise of discretion. His

*Despite Appellant's argument (Brief, pp. 21-23) premised on the Referee's "substantial equity" finding [C. T. p. 28, lines 18-25], which rests solely on Mr. Herter's opinion as an "owner" [R. T. 12/27/66, pp. 83, 90-91] that there was a huge equity after *four* trust deeds (65% of the value), an 11 *U.S.C.* §714 injunction here plainly caused "substantial injury" to Appellee. Appellee is the 3rd Trust Deed holder and junior to United California Bank and Preissman and May [Ex. 3; R. T. 12/27/66, p. 4; R. T. 1/5/67, pp. 2-3]. At such time as such senior trust deed holders cause a sale thereunder, Appellee must be ready to bid in cash, the amounts due thereon, including the interest and costs accrued, or have its security wiped out. *Sohn v. California Bank,* 124 Cal. App. 2d 757, 269 P. 2d 223; *Streiff v. Darlington,* 9 Cal. 2d 42, 68 P. 2d 728. While a secured creditor can be compelled to forego interest, *pendente lite,* without detriment (*Vanston v. Green,* 329 U.S. 156), a junior lienholder who must stand ready to *advance* additional funds in the future to protect its security is substantially injured by a stay.

naked conclusion that an injunction should issue was hence clearly subject to review and reversal free from any presumption of correctness.

In ignoring and rejecting Appellee's offer to do equity by paying all the unsecured creditors in full, forthwith [R. T. 12/27/66, pp. 6-17], the Referee plainly "violated the rules of equity."

Maas v. United States, supra.

And in so rejecting Appellee's offer to pay the unsecured creditors in full, forthwith, in favor of the Debtor's proposed six year plan of arrangement, the Referee was guilty of an "improvident grant" of an injuncion, since under the undisputed facts, *no* possible plan of arrangement could be fair, equitable and feasible when compared, with the unsecured creditors' opportunity to be paid in full, forthwith.

Case v. Los Angeles Lumber Co., 308 U.S. 101, 114;

Technical Color & Chem. Works v. Two Guys From Massapequa, 327 F. 2d 737, 741.

Furthermore, on the undisputed facts of this record, there is no substantial evidence (indeed no evidence at all) that the injunction was "necessary to facilitate the primary purpose" of the Chapter XI proceeding. A finding that the injunction was necessary to secure the orderly payment of unsecured creditors would have been "clearly erroneous".

Finally, under the plainest principles of equity, the alleged co-partners should be estopped to claim title to

the land to restrain Appellee's lien by a Chapter XI proceeding in any event, because they allowed Heiter to appear as the true owner and obtain money on the strength of his record title.

Butler v. Woodburn, 19 Cal. 2d 420, 425, 122 P. 2d 17, 20;

Andrade v. Casteel, 81 Cal. App. 2d 729, 185 P. 2d 51, 52;

Mills v. Rossiter, 156 Cal. 167, 103 Pac. 896-897;

Kierulff v. Metropolitan S. Co., 315 F. 2d 839, 842-843, 9 Cir., 1963;

Jeggle v. Mansur, 17 F. 2d 729, 9 Cir., 1927, cert. den. 274 U.S. 758.

Appellee would not have dealt with Barnes, or made the loan to a partnership where Barnes was a partner [R. T. 12/27/66, pp. 70-71]. Having induced Appellee to enter the transaction by allowing Herter to hold record title and represent *his* ownership while concealing Barnes' interest [Ex. 4, ¶ 1a; 6], the partners are estopped to assert that the land was and is a partnership asset to Appellee's detriment.

Farmers Bros. Co. v. Huddle Enterprises, Inc., 366 F. 2d 143, 148, 9 Cir., 1966.

4. The Scope of Review by the Court of Appeals.

When the district court, without taking any additional evidence, rejects the referee's findings, makes contrary findings of his own, and reverses the referee's determination, the court of appeals tests the referee's findings under the "clearly erroneous" rule.

Lines v. Falstaff Brewing Co., 233 F. 2d 927, 9 Cir. 1956.

However, the "clearly erroneous" rule does *not* apply to the referee's conclusions of law, *i.e.* "an erroneous interpretation of the standard to be applied".

Utley v. United States, 304 F. 2d 746, 9 Cir., 1962;

Lama Company v. Union Bank, 315 F. 2d 750, 9 Cir., 1950;

Solomon v. Northwestern State Bank, 327 F. 2d 720, 724-725, 8 Cir., 1964;

In re Lightner, 184 F. Supp. 825, S.D. Cal.

Here, it was the Referee's errors of law and failure to find on material issues which led the District Court to reverse—not the referee's findings.

Where, as here, the referee's "findings" are either silent on the pivotal issues or are so sparse that the district court cannot determine what standard the referee applied in awarding the injunction (*Commissioner v. Duberstein,* 363 U.S. 278, 292) the district court has not only the power but the duty under General Order No. 47, to "modify" the referee's report as appropriate.

Carter v. Kubler, 320 U.S. 243, 247-249.

In such a case, it is the district court's findings—which are not contrary to the referee's findings—which are reviewed by the court of appeals.

The question of whether an 11 *U.S.C.* §714 injunction should issue in a particular case rests in the referee's "discretion" *provided* he has applied the correct legal standard in reaching his conclusion.

But where, as here, the District Court has determined that the Referee did *not* apply the correct legal standard, and makes new findings, applying the correct standard,

". . . Manifestly when a district judge so proceeds it is *his* findings of fact and conclusions as to which the 'clearly erroneous' standard of Rule 52, F.R. Civ. P. should be applied." (Italics added).

Employers Mutual Casualty Co. v. Hinshaw, 309 F. 2d 806, 809, Fn. 2, 8 Cir., 1962.

Here, the Referee's finding of an "equity" [C. T. p. 28, lines 18-25] was not overturned. What the District Court did was to make an independent review of the record, decide that the individual partners' solvency *was* material, decide that Appellee's offer to pay [R. T. 11/27/66, pp. 6-17] repeated in the District Court [R. T. 5/1/67, pp. 19-23] foreclosed a lengthy "plan of arrangement", and make appropriate findings and conclusions. The Referee's "equity" finding then became moot. An "equity" *qua* equity is not enough for an 11 *U.S.C.* §714 injunction. There must be an insolvent debtor *and* unsecured creditors, *and* the plan (which the lien enforcement would embarrass) must be "fair and equitable".

5. Appellant's Misconception of a Referee's "Discretion."

Appellant's Brief (pp. 13-14) evidences a common misapprehension—that the precise meaning of "discretion" can be expressed as a universal verbal formula.

Quoting liberally from *Lines v. Falstaff Brewing Co.,* 233 F. 2d 927, 932, 9 Cir., appellant seems to suggest that a trial court (or a referee) can never be said to have "abused" his discretion unless "no reasonable man" would take the view adopted, and that such "reasonable man" rule adds additional precision to a determination of whether discretion has been abused.

On the contrary, "discretion" is a chameleon-like concept in the law which takes on the coloration of its surroundings. The true rule is that there is no magic verbal touchstone. As the Supreme Court has put it in *Langnes v. Green,* 282 U.S. 531, 541:

> "The term 'discretion' denotes the absence of a hard and fast rule."

Here, if regard is given to what is right and equitable "under the circumstances and the law" (*Langnes v. Green, supra*) governing the summary jurisdiction of the Bankruptcy Court to enjoin secured creditors, no "reasonable man" (*i.e.* no reasonable, experienced judge) would have issued the order the Referee did. But the determination of whether the Referee "abused his discretion" is clouded, not aided by the "reasonable man" gloss.

Here, as in the *Langnes* case, the problem presented by the Appellee's offer to pay all unsecured creditors in full was quite simple.

Upon the face of the record, appellee's offered payment would afford the Debtor all the relief it was entitled to in a Chapter XI proceeding—the payment of unsecured creditors in an orderly and expeditious manner.

The difference in the effect of adopting one or the other of the two alternatives presented to the Referee and the District Court was obvious. To retain the Chapter XI proceeding and proceed with the proposed plan while enjoining the secured creditors' normal enforcement of their liens, would be to permit the Debtor to "rehabilitate" itself over the six year plan, but to rob the unsecured creditors of the opportunity to have

their claims paid at once in full, and to freeze the secured creditors' assets; to allow Appellee to pay the unsecured claims and expenses of administration, dismiss the proceeding and remit the parties to their rights and remedies under California law would be to preserve the rights of both parties and accomplish the primary purpose of a Chapter XI proceeding.

The mere statement of these diverse results is, as in the *Langnes* case, "sufficient to demonstrate the justice of the latter course."

B. The District Court Correctly Held That the Solvency and Ability of Individual Partners to Pay Partnership Debts as They Mature Is Material to the Solvency and Ability of the Partnership to Pay Its Debts (11 U.S.C. §723), and That in Ruling to the Contrary and Awarding an Injunction, the Referee "Abused His Discretion."

The Chapter XI Petition filed on December 20, 1966, was signed by each of the four alleged partners, but it was filed *solely* on behalf of "Casa Dorinda Estates". The Petition alleged that such alleged partnership was "unable to pay its debts as they mature" and proposed an "arrangement" [Debtor's Petition, p. 1, lines 28-30], under which an alleged $7,177.44 in partnership unsecured debts [Debtor's Petition, Schedule A-3] would be paid over a six (6) year period after confirmation [Proposed Plan of Arrangement]. The solvency of the individual alleged partners and their individual ability to pay debts as they matured was not referred to in the Petition.

At the Order to Show Cause hearing, the alleged Debtor offered no evidence as to either the partner-

ship's inability to pay its debts or of the individual inability of the partners to pay such debts.

Charles B. Herter, Jr., one of the alleged partners, testified that he had individual assets of his own, including an airplane which he used like ordinary men use an automobile [R. T. 12/27/66, p. 47, lines 13-21]. The Referee sustained an objection of immateriality to further inquiry into the assets of the individual partners [R. T. 12/27/66, p. 27, lines 4-11]. Appellee offered to prove that each of the individual alleged co-partners had the ability to pay the alleged unsecured debts [R. T. 12/27/66, p. 28, lines 13-19]. The Referee rejected such offer, ruling that the individual solvency of such partners was "immaterial" to the issue of the Debtor *partnership's* solvency [R. T. 12/27/66, p. 28, lines 20-21], and the question whether an 11 *U.S.C.* §714 injunction was proper.

The law is clear that under an allegation of *partnership* insolvency, the insolvency of the *individual* partners must be proven.

11 *U.S.C.* §§702, 706, 707, 711, 723;

Mason v. Mitchell, 135 F. 2d 599, 9 Cir., 1943;

Kaufman-Brown Potato Co. v. Long, 182 F. 2d 594, 601-602, 9 Cir., 1950;

Charles Arnold & Associates v. England, 301 F. 2d 572, 574, 9 Cir., 1962;

In re Pauline's Fashion Salon, 121 F. Supp. 845, 852, S.D. Cal. 1954;

Young v. Riddell, 283 F. 2d 909, 910, 9 Cir., 1960;

(Each partner is "personally liable for the debts and liabilities of the partnership");

9 *Am. Jur. 2d* 179-180, Bankruptcy §169.

The reason for this is that even when the partnership alone is the Debtor, the Bankruptcy Act required that each individual partner "surrender" such of "his individual property" as is required to pay the partnership debts.

11 *U.S.C.* §23;

Liberty National Bank v. Beat, 276 U.S. 215, 224, 72 L. ed. 536, 540.

And if, after such surrender and payment, there are no unsecured debts, the issuance of an 11 *U.S.C.* §714 injunction against secured lien enforcement would be improper, because no "arrangement" is necessary.

On oral argument as to whether the preliminary injunction should issue, Appellee cited *Mason v. Mitchell,* 135 F. 2d 599, 9 Cir., 1943, and argued that the threshold prerequisite (11 *U.S.C.* §723) to the exercise of summary discretion (11 *U.S.C.* §714) had not been proven [R. T. 1/5/67, p. 38, line 21, to p. 40, line 23].

The Referee held that individual partners could lawfully *insulate* their individual assets from their partnership's debts; that an allegation of the *partnership's* insolvency or inability to pay in the Debtor's Petition would support a summary stay of a secured lien regardless of the individual partners' solvency and ability to pay such debts [R. T. 1/5/67, p. 40, line 24, to p. 43, line 17].

The Referee clearly erred in rejecting the offer of proof and in his construction of the statutory prerequisites to summary discretion to issue an injunc-

tion. Despite the fact that the 11 *U.S.C.* §723 solvency issue was presented [C. T. 7-8], the Referee made no findings on such issue.

The District Court correctly found and concluded that the Referee had erred [F. of F. 2, 3, C. of L. II, III, IV, C. T. 52, 53], and found and concluded that the Referee had "abused his discretion" in granting the preliminary injunction [F. of F. 8, C. of L. VII, C. T. 54-55].

The Referee's failure to find upon this key issue of insolvency would alone have justified the District Court in finding an abuse of discretion awarding the injunction.

The award of an injunction is never a matter of right, but is a matter of sound judicial discretion.

> *Yakus v. United States,* 321 U.S. 414, 420, 88 L. ed. 834, 857.

Thus, it is "of the highest importance" that adequate, comprehensive findings be made.

> *Mayo v. Lakeland Highlands Can Co.,* 309 U.S. 310, 316, 84 L. ed. 774, 779.

The Referee's failure to find justified the District Court in making its own findings and conclusions on this crucial issue, and in finding and concluding that the Referee "abused his discretion" in granting the injunction.

C. The District Court Correctly Remanded the Matter to the Referee to Allow Appellee to Pay the Unsecured Debts and Reasonable Costs of Administration.

At the hearing before the District Court, Appellee renewed its offer to pay all the unsecured debts and the reasonable costs of administration [R. T. 5/1/67, pp. 19-24].

The Court then ruled that the Referee lacked the power to issue the injunction in the face of Appellee's offer [R. T. 5/1/67, pp. 23-24].

The District Court made appropriate findings and conclusions and an Order, reversing the Referee and remanding the matter [F. of F. 4, 5, 6, 8; C. of L. V, VI, VII; Order; C. T. 53-55, 56, lines 17-26]. *General Order No. 47,* General Orders in Bankruptcy.

Appellant now challenges such Order (Brief, pp. 18, 21-23). The basis of such challenge is the assertion, unsupported by authority, that the partnership Debtor is "entitled to receive the rehabilitation benefits of a Chapter XI proceedings" (Brief, p. 21), together with the argument that there is a substantial equity in the property and that Appellee hence will assertedly suffer no substantial injury by the continuance of the injunction (Brief, pp. 21-23).

There is grave doubt whether there *is* "substantial evidence" in support of the Referee's finding of an equity. But even if there be an equity, Appellant's remedies lie under California law*—not Chapter XI. A secret partnership short of partnership cash, but whose members are solvent, cannot in equity forestall

*If there be a $665,000 equity, as Appellant asserts (Brief p. 22), there will be plenty of bidders at the trustee's sale.

secured creditors who dealt with a solvent individual partner, by claiming that the secured property is really the partnership's. The equitable doctrines of "clean hands" and "he who seeks equity must do equity" forbid this. And when the secured creditor offers, in addition, to pay the unsecured partnership debts, all justification for a stay disappears.

Appellee's offer to pay all of the unsecured creditors forthwith, in full [R. T. 12/27/66, pp. 6-17], and its tender of a cashier's check with which to do so, completely undercut the Debtor's position.

Without unpaid unsecured debts, there would be nothing to "arrange" and no legal or equitable basis for a Chapter XI arrangement proceedings (11 *U.S.C.* §§702, 707, 711, 723).

The Referee apparently adopted the Appellant's argument (which Appellant now attempts to support) that the "rehabilitation" of a Debtor without unsecured debts is a proper and lawful basis for the restraint of secured creditors under 11 *U.S.C.* §714.

Appellant now asserts that the "rehabilitation" of a Debtor is "a primary purpose" of Chapter XI proceeding (Brief, pp. 16-18).

Appellant misreads the authorities it cites for such asserted proposition.

To be sure, the "rehabilitation" of debtors is a broad purpose and goal of the entire Bankruptcy Act.

Chapter XI proceedings are a method of adjusting unsecured debts and the debtor's ultimate financial rehabilitation resulting therefrom.

> *S.E.C. v. American Trailer Rentals,* 379 U.S. 594, 605-607.

But although the "goal" of a Chapter XI proceeding is the "rehabilitation" to be achieved by the arrangement of unsecured debts (*Nicholas v. United States,* 384 U.S. 678, 687), such "goal" does not expand the Bankruptcy Court's summary power over secured creditors, which is dependent upon the existence of unsecured debts. Nor does such "goal" authorize the Bankruptcy Court to alter the rights of secured creditors (*S.E.C. v. United States Realty Co.,* 310 U.S. 434), in order to "rehabilitate" the Debtor as to secured debts.

There are few land-poor speculators who would not welcome a moratorium on their secured debts and the chance to sell the land slowly, without regard to the cost of money. Doubtless a semantic argument can be made that such a moratorium would "rehabilitate" a speculator who was short of ready cash with which to pay the installments on his secured debts. This, however, is *not* the "rehabilitation" contemplated by Chapter XI, nor would it be constitutional.

Conclusion.

It would be hard to imagine a clearer case of commercial dishonesty than the scheme laid bare by the record in this case.

A group of land speculators secured funds by putting forward their most affluent and personable member as the record owner and "front man", and secured such loans by trust deeds on the land. Upon default in the

payments on the trust deeds and taxes, and threatened foreclosure, the secret partnership surfaced, filed a Chapter XI Petition in the name of the partnership, and sought an injunction restraining the lender's enforcement of their secured liens during the pendency of a six (6) year "Plan" of arrangment to pay $7,177.14 in alleged partnership unsecured debts.

The Referee saw nothing reprehensible in either the scheme or the speculators' fraud and mendacity [R. T. 1/5/67, p. 62, lines 20-26] and granted the injunction.

The Appellant now challenges the District Court's Order of reversal, arguing that it was error for the Court to find that the Referee "abused his discretion", and to dissolve the injunction as to Appellee (the third trust deed holder), and asserting that the partnership should be allowed to "rehabilitate" itself.

The appeal, though frivolous, has accomplished further delay. The title is still clouded by the Chapter XI proceedings. No payments have been made on taxes or the trust deeds in the 12 months the matter has been pending.

The alleged Debtor's *real* problem is not the $7,177.14 in unsecured debts, but the "partners' " hope to sell the land for more than the trust deed debts and taxes. Such persons' remedy was a Chapter XII proceedings —not Chapter XI. Here, as in *Securities & Exch. Commission v. United States R. & Imp. Co.*, 310 U.S. 434, where the proper remedy was Chapter X (rather than Chapter XI) "it was plainly the duty of the district

court" to remand with a direction that the proceedings be dismissed upon Appellee's payment of the unsecured creditors and the reasonable expenses of administration.

The Order of the District Court was clearly correct and should be affirmed.

December 19, 1967

Respectfully submitted,

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By NORMAN ELLIOTT,
Attorneys for Appellee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

NORMAN ELLIOTT

No. 22,106

IN THE

United States Court of Appeals

For the Ninth Circuit

CASA DORINDA ESTATES, also known as SANTA MARIA ACRES APARTMENTS, a copartnership, et al., Debtor,

Appellant,

vs.

ALL-YEAR WEATHER, INC.,

Appellee.

On Appeal from the United States District Court for the Central District of California

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

SUMMARY OF ARGUMENT

The Referee sat at the trial Court in this matter. He made adequate findings of fact and conclusions of law to support his order restraining foreclosure proceedings by Appellee. There is substantial uncontradicted evidence in the record to support his findings. They are not clearly erroneous. In fact they are the only ones that could have been made upon the evidence introduced at the hearing. The granting or denying a petition for a restraining order is a matter that lies within the reasonable discretion of the Referee. There is no showing of any abuse of this discretion.

Whether or not the District Court rejected the Referee's findings, such findings of the Referee are decisive upon appeal unless clearly erroneous. The purported findings and conclusions of law of the District Court should be disregarded on appeal unless those of the Referee are clearly erroneous.

The doctrines of estoppel and fraud have no application in this matter. There has been no change of position by Appellee or anyone to his detriment. Appellee has received each and every thing it was to receive in any agreement with Herters or Appellant. It has sustained no damage whatsoever. There can be no doubt that the Appellant has a very substantial equity in its property which will keep Appellee fully secured for a considerable period. It therefore cannot suffer any substantial injury by a delay for a reasonable part of that period so that Appellant may have an opportunity to realize upon such equity and rehabilitate itself.

THE FINDINGS OF FACT AND CONCLUSIONS OF LAW MADE BY THE DISTRICT COURT DO NOT CONTROL IN THIS APPEAL.

The Referee presided at a hearing at which testimonial and documentary evidence was received. He made findings of fact and conclusions of law based on this evidence. Upon review of the Referee's order the District Court received no evidence whatsoever, not a single witness testified and not a single document or exhibit was received. Yet the District Court purported to make findings of fact. In this connection it

is to be noted that the District Court crossed out and thereby refused to make a purported "finding" that the Referee's findings of fact and conclusions of law were clearly erroneous. In view of the evidence and the facts it could not have done otherwise.

Findings No. 2 and No. 3 of the District Court are not findings of fact based upon evidence but are merely a statement of a portion of the proceedings had before the Referee. Even if a partnership is held not to be an entirely separate legal entity in Chapter XI proceedings and the Referee erred in sustaining the objection to the question of whether Dr. Barnes owned property not listed in the debtor's schedules, then the matter should have been remanded to the Referee to receive evidence in this connection.

Findings Nos. 4, 5 and 6 of the District Court are not "findings of fact" based on evidence. They, too, are a statement of an occurrence in the proceedings before the Referee and before the District Court. The offer before the Referee had six (6) conditions attached to it (R.T. 12/27/66 pp. 6-7). No offer to pay the reasonable costs of administration was made before the Referee. Finding No. 7 was crossed out; the District Court thereby refusing to "find" the Referee's findings and conclusions were clearly erroneous. Finding No. 8 that "The Referee abused his discretion in restraining All-Year Weather, Inc. . . .", is a pure legal determination upon review. It is not a "finding of fact or a conclusion of law" in the sense used in connection with the issuance of a judgment or order upon a contested hearing before a trial judge. Upon

a review of a Referee's order the District Court sits as an Appellate Court and renders an opinion as to the correctness of the proceedings before the Referee. It does not substitute its findings or conclusions for those of the Referee unless those of the Referee are clearly erroneous. It does not substitute its discretion for that of the Referee unless the Referee has clearly abused his discretion. Even though the Referee erred in sustaining an objection (which Appellant denies), this does not mean he has abused his discretion in granting a restraining order. No one knows what the facts are about the individual partners' ability to pay the debts of the partnership although Appellee repeatedly *assumes,* without any evidence or basis, throughout its brief that the partners had such ability. Evidence upon this point was excluded.

THE REFEREE'S FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER ARE CONCLUSIVE UPON AN APPEAL UNLESS THEY ARE CLEARLY ERRONEOUS.

Upon an appeal from an order of a District Court reversing an order of a Referee, the Appellate Court recognizes and acts upon the findings of fact, conclusions of law, and order of the Referee unless they are clearly erroneous.

Lines v. Falstaff Brewing Co., 9 Cir., 233 F. 2d 927, 930 (Appellant's Opening Brief, p. 13);
Snider v. England, 9 Cir., 374 F. 2d 717 (Appellant's Opening Brief, p. 15);
Lundgren v. Freeman, 9 Cir., 307 F. 2d 104 (Appellant's Opening Brief, p. 15).

The conclusions of law and any order of a Referee wherein his discretion is involved are binding upon appeal unless such conclusions are clearly erroneous or the Referee abused his discretion. Any litigant contending the Referee abused his discretion, as Appellee did upon review before the District Court, must make a strong showing of prejudice to itself.

In *Hoppe v. Rittenhouse*, 9 Cir., 279 F. 2d 3, at page 9 it is stated:

> "The rule applied in Fazio is pertinent where the primary facts can fairly be said to admit of but one reasonable *conclusion* (emphasis added), and yet this principle does not change the equally settled rule that where the basic and undisputed facts are fairly susceptible of diverse inferences requiring different conclusions, the determination made by the trier of fact (Referee) is conclusive on review unless that finding is 'clearly erroneous' ".

In *California Airmotive Corp. v. Bass,* 9 Cir., 354 F. 2d 453, at page 455, it is stated:

> "As we have previously written, 'In the conduct of any judicial or quasi-judicial hearing, reasonable discretion must be vested in the officer (Referee) who guides the course of the proceedings. We could not find an abuse of such discretion absent a *strong showing of prejudice* to the litigant making the charge of such abuses . . ." (emphasis added).

Accord:

> *In Re Tyne,* 9 Cir., 234 F. 2d 907 (Re partnership ownership of real property).

Therefore, despite Appellee's contentions to the contrary, the Referee's findings of fact, conclusions of law, and exercise of discretion are controlling on appeal unless clearly erroneous or the order was unreasonable and therefore an abuse of discretion.

THE FINDINGS OF FACT OF THE REFEREE ARE ADEQUATE TO SUPPORT THE REASONABLE EXERCISE OF HIS DISCRETION IN GRANTING THE RESTRAINING ORDER.

Appellee states on page 13 of its Brief that the findings are sparse and implies they are inadequate to support the Referee's order. The Referee made specific findings of the value of Debtor's property and the total of all liens on it, thereby establishing Debtor had an equity of $665,000.00 in its property (C.T. p. 28, lines 18-25). Upon the *facts* presented to the Referee only one further finding or conclusion could have been made in addition to those actually made. Evidence was introduced to the effect that interest was accuring upon the total liens on Debtor's property at the rate of $2,000.00 per month (R.T. 12/27/66 pp. 4-5). Upon this basis a finding or conclusion could have been made to the effect that an order restraining foreclosure of Appellee's trust deed upon Debtor's property for a reasonable time would cause Appellee no substantial injury. Debtor's equity of $665,000.00 will keep Appellee fully secured for any such reasonable period.

The Referee's findings of fact are fully adequate to support the order restraining Appellee from foreclosing. The fact that Appellee would not be substantially

injured by the restraining order is a negative proposition rejected by the Referee and no finding to such negative effect is required. Only the facts essential to support the order need to be found. The finding that the restraining order would not cause Appellee any substantial injury can be inferred from the finding that establishes that Debtor has an equity of $665,000.00 in its property.

In 5 *Moore's Federal Practice,* at page 2656, it is stated:

> "The ultimate test as to the adequacy of findings is whether they are sufficiently comprehensive and pertinent to the issue to form a basis for the decision and whether they are supported by the evidence. In addition, they should be concisely stated, non-argumentative, and free from conclusions of law and redundancy. . . Findings need not assert the negative of rejected propositions."

at page 2659:

> "And the Court need not find on every issue requested, but a finding of such essential facts as lay a basis for the decisions is sufficient."

at page 2661:

> "Findings of the trial Court (Referee here) 'are to be construed liberally in support of a judgment or order. Whenever, from facts found, other facts may be inferred which will support the judgment, such inferences will be deemed to have been drawn' ".

The Court is required to make only such findings of fact as will support the judgment and not all such

findings as will fully present every possible view of the case.

> *Sonken-Galamba Corp. v. Atchison, Topeka & Santa Fe Ry. Co.* (W.D. Mo. 1940) 34 F. Supp. 15.

In 5 *Moore's Federal Practice,* at page 2660, it is stated:

> "Clearly the rule does not require the Court to make elaborate findings upon all such facts as will present every possible view of the case."

Appellee belittles the definition of discretion as made in *Lines v. Falstaff Brewing Co.,* 9 Cir., 233 F. 2d 927, 932, as being "reasonable man gloss" (Appellee's Brief, p. 15). It is apparent Appellee does not feel a reasonable exercise of judgment is a proper use of discretion. When Appellee has no answer as to the existence of a fact or proposition of law it seeks to offset the effect thereof by use of derogatory adjectives.

REHABILITATION OF THE DEBTOR IS A PRIMARY PURPOSE OF A CHAPTER XI PROCEEDINGS.

Appellee repeatedly throughout its Brief (pp. 6, 10, 11, 15, 16 and 21) states and implies that the payment of unsecured creditors is the sole purpose of a Chapter XI proceedings. Appellant respectfully submits that the authorities cited and quoted from on pages 16-18 of its opening brief clearly establish that rehabilitation of the Debtor is also a primary purpose of such a proceedings and that the powers

given the Bankruptcy Court are equally available for both of such purposes. This principle is well supported by authority contrary to Appellee's contention.

Appellee on page 6 of its Brief cites *In re Tracy,* 194 F. Supp. 293, N.D. Cal. 1961, and *In re Brown,* 84 F. 2d 433, in support of its statement that the payment of unsecured creditors is the primary purpose of a Chapter XI proceedings. Neither of these cases are authority for the proposition that payment of creditors is the sole purpose of a Chapter XI proceedings or that rehabilitation of the Debtor is not also a primary purpose of such a proceedings, or that *both* purposes should not be accomplished if possible. In fact these case are authority to the effect that keeping the Debtor in business and protecting the equity for the benefit of the Debtor itself is also a purpose of such a proceeding.

In re Tracy, 194 F. Supp. 293, N.D. Cal. 1961, at p. 295, it is stated:

> "A Chapter XI proceeding may arrange only the rights of unsecured creditors, without alteration of the rights of secured creditors (citations). Nevertheless, the Court may, upon notice and for cause shown, stay or enjoin any act to enforce a lien upon the property of a debtor (citations). The exercise of this power lies within the discretion of the Referee, and his decision to exercise such power must be sustained unless he has abused that discretion. . . .
>
> "Its objective (Chapter XI proceeding) is to pay his unsecured creditors in an orderly and expeditious manner, AND *to keep him, if possible,*

> *from being put out of business by his unsecured creditors.*" (All emphasis added.)

In re Brown, 7 Cir., 84 F. 2d 433, at 434, it is stated:

> "A court of equity, however, has the power to enjoin the holders thereof from an immediate sale, *if such sale will operate to the injury of the DEBTOR, as well as to other creditors* (all emphasis added). This power is given the Court upon the theory that there may be an *equity* in the pledged security over and above the amount of the indebtedness secured thereby, and that such *equity* will inure to the benefit of the *debtor* and of his other creditors." (Emphasis added.)

Appellee contends on page 12 of its Brief that Debtor should be estopped to claim title to the property because it allowed Herter to appear as owner and borrow money and give a deed of trust. Appellant concedes that Appellant should be estopped to deny Herter had title to an extent that the deed of trust given by Herter to Appellee should be held valid. Appellant has never contended Appellee's deed of trust is not valid. In fact Appellant stipulated as to its validity in the above entitled proceedings. The principle of estoppel is not applicable beyond Herter being held to be the actual owner for the purpose of giving said deed of trust.

The cases cited by Appellee on page 12 of its Brief so limit the effect of any such estoppel. No damage has been suffered by Appellee for it has *received everything* it bargained for with the Herters, e.g. the

personal liability of the Herters and a valid deed of trust on the property. Damage is a necessary element of estoppel.

Kierulf v. Metropolitan Stevedore Co., 9 Cir., 315 F. 2d 839, 842.

Therefore Appellant is making no claim or contention whatsoever that it should be estopped from making and estoppel has no application to this matter.

A PARTNERSHIP QUALIFIES AS A DEBTOR IN A CHAPTER XI PROCEEDINGS SEPARATE AND APART FROM PARTNERS AND THE QUESTION OF THE SOLVENCY OF INDIVIDUAL PARTNERS IS IMMATERIAL TO SUCH AN ARRANGEMENT PROCEEDINGS.

The Referee sustained an objection to a question inquiring into what assets an individual partner possessed. If this was reversible error the matter should be remanded for the purpose of receiving such evidence. There is no evidence in the record establishing the assets and liabilities of either partner or establishing their individual solvency. However, this has not prevented Appellee from assuming the partners are solvent. Appellee states, entirely without support, repeatedly in its Brief (pp. 4, 5, 9 and 20) that the partners were solvent. There is no basis whatsoever for this statement in the record. Appellee does not hesitate to assume any fact it feels might be advantageous to its cause. It accuses the Appellant of filing a frivolous appeal and of fraud and mendacity without any grounds therefor whatsoever upon the basis of fictitious facts it has assumed.

It is true that in a straight bankruptcy matter that the assets and debts of individual partners are considered in determining the solvency of the partnership. In straight bankruptcy proceedings the legal definition of insolvency is used—that is the relationship of the reasonable value of all assets to the total of all liabilities. In a Chapter XI proceedings the equity definition of solvency—ability to pay debts as they mature (11 U.S.C. 723) is used.

In the instant case the Debtor partnership is *solvent* in the legal sense. Its assets, of its own with no reference to whatever assets, if any, of individual partners, exceeds its liabilities by $665,000.00. Thus the question of what additional assets individual partners may have is immaterial. The question involved here is whether or not in this circuit, by virtue of the decision in this case, it is to be the law that under 11 U.S.C. 723 a partnership Debtor must allege that it, as a separate entity, is unable to pay its debts as they mature or allege that it and its individual partners are unable to pay its debts as they mature. Appellant respectfully submits that in a Chapter XI proceedings a partnership should be considered a legal entity in and of itself, separate and apart from its partners. Otherwise many problems of subordination in respect to individual creditors and further contribution of capital by partners will arise. In any event creditors always have their right to proceed directly against the partners on their personal liability for partnership debts.

For a general discussion to the effect that a partnership should be held to be such a complete separate entity see 1 *Collier on Bankruptcy,* Sec. 5.03, p. 693 et seq.

APPELLANT HAS A SUBSTANTIAL EQUITY IN ITS PROPERTY WHICH SHOULD BE PRESERVED FOR ITS BENEFIT AS WELL AS THE BENEFIT OF ITS CREDITORS.

Appellee in its Brief at page 20 states there is grave doubt if Appellant has a substantial equity in its property. Again Appellee has made a vague general statement without any supporting facts or reasons. The evidence as to value received on December 27, 1966 is clear. It stands uncontradicted in the record (R.T. 12/27/66, pp. 83, 90). It is corroborated by evidence of actual sales of a parcel of Appellant's property and other comparable sales (R.T. 12/27/66, pp. 85, 87). Appellee had full opportunity and ability to offer evidence pertaining to value. It made no attempt to offer any such evidence at the initial hearing on December 27, 1966 or at the continued hearing on January 5, 1967 after it had heard the evidence of Appellant as to value. Instead of putting on proof Appellee has resorted to unsupported sly innuendoes in its Brief that the evidence received and acted upon by the Referee should be disregarded on review and appeal. Many partnerships hold record title to realty in the names of individual partners. There is nothing wrong with this. What fraud is Appellee accusing Appellant of? Appellee has been defrauded of nothing. It has received everything it

bargained for with the Herters. There is no fraud and no one has suffered any damages.

In 23 *Cal. Jur.* 2d, at p. 99, it is stated:

> "It is an established principle of law and equity that, in the absence of a statute specifically giving a right of action, fraud which has produced and will produce no injury furnishes no ground of action or defense. . . . Likewise, in the absence of a confidential relationship, where a purchaser of land obtains the identical property he intends to purchase and is not deceived as to its quantity or quality and the property is worth all that is paid for it, he cannot complain because the seller has a collateral personal interest in the sale."

Title was placed in Herter's name for purpose of obtaining desired zoning only. Appellant does not dispute the validity of Appellee's trust deed or that it owes the amount of the debt contracted by Herters with Appellee. Appellee has the obligation of the Herters to pay the debt. It has a valid trust deed on the real property. What more was it to receive? Of what has it been defrauded? Zoning permits property to be used by anyone in the world for certain uses. It is objective. It should be immaterial as to who owns it but personalties arise between applicants and members of planning commission. However, no change of zoning has been obtained and no one whomsoever has been misled to any degree to his detriment. There has been no fraud or mendacity and none has been shown. Such vague general charges are easy to make by insinuation and are difficult to refute.

CONCLUSION

The Referee's findings, conclusions and order are fair and reasonable and should be affirmed upon this appeal. Appellant is not requesting that Appellee's debt or lien be held invalid. Appellant is only requesting that Appellee be restrained, while remaining fully secured, for a reasonable time so that Appellant's equity in its property will not be forfeited by foreclosure.

Dated, Fresno, California,
January 5, 1968.

Respectfully submitted,
W. A. McGugin,
Attorney for Appellant.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

W. A. McGugin,
Attorney for Appellant.